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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 13

THE UNITED STATES OF AMERICA, PETITIONER

vs.

ASHBY OLIVER STEWART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED JANUARY 26, 1940
CERTIORARI GRANTED MARCH 25, 1940

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In the United States District Court in and for the Northern District of California, Northern Division.

No. 20379-S

ASHBY OLIVER STEWART,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

PETITION

Ashby Oliver Stewart brings this petition against the United States of America, pursuant to the provisions of Section 41, Paragraphs (5) and (20) of Title 28 of the United States Code, and, for a cause of action alleges as follows:

I. Your petitioner resides in the City of Atherton, in the County of Santa Clara, State of California.

II. The nature of your petitioner's claim is for a refund of income taxes not exceeding $10,000.00 erroneously and unlawfuly assessed against your petitioner, and collected from your petitioner for the year 1931.

III. Prior to the year 1931, your petitioner purchased bonds with appurtenant accrued and unaccrued interest coupons, issued under the provisions of the Federal Farm Loan Act of 1916 (29 Stat. 360, amended 41 Stat. [1*] 1454) by the Kansas City

*Page numbering appearing at the foot of page of original certified Transcript of Record.

Joint Stock Land Bank, (a Corporation organized under the provisions of said Federal Farm Loan Act), in the aggregate principal amount of $886,000, for the sum of $504,275.74. In 1931, your petitioner surrendered to the Receiver of said Kansas City Joint Stock Land Bank (who was duly appointed as such Receiver by the Federal Farm Loan Board pursuant to Section 29 of said Federal Farm Loan Act) the aforesaid bonds and appurtenant coupons issued by said Bank and received from said Receiver in exchange therefor liquidating dividends totalling $580,636.69. At the time your petitioner surrendered said bonds, there was due on said bonds in accrued unpaid interest the sum of $183,352.77. Said sum of $580,636.69 was paid pursuant to the covenants contained in said bonds and in accordance with resolutions adopted by the Federal Farm Loan Board on June 24, 1931, and November 20, 1931; in accordance with said resolutions, said sum was prorated by said Bank and received by your petitioner in the amount of $483,864.69, or approximately 83.4% thereof, as principal, and $96,772.00, or approximately 16.6% thereof, as interest.

IV. Prior to 1931, your petitioner purchased bonds with appurtenant accrued and unaccrued interest coupons issued under the provisions of the aforesaid Federal Farm Loan Act of 1916 by the Bankers Joint Stock Land Bank of Milwaukee, (a Corporation organized under the provisions of said Federal Farm Loan Act) in the principal aggregate amount of $90,000.00 for the sum of $19,335.00. In 1931, petitioner sold said bonds and appurtenant coupons of the Bankers Joint Stock Land Bank of

Milwaukee for the sum of $27,250.00. At the time of the sale, there was due on said bonds accrued unpaid interest the sum of $16,645.83.

V. The bonds referred to in paragraphs III and IV hereof recited upon their face the exemption expressed in Section 26 of the Federal Farm Loan Act in words and figures as follows, to-wit:

> "This bond is issued under the authority of the Act of Congress approved July 17, 1916, which provides that farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, Municipal and local taxation." [2]

VI. The Defendant has, since the enactment of the said Farm Loan Act, at all times, through duly authorized representatives, held out and represented to petitioner and others, by letter, statement, circular and advertisement, that bonds issued by Joint Stock Land Banks under the provisions of said Act were and are exempt from all forms of taxation, and that income derived therefrom through the sale, conversion, or surrender thereof, was and is exempt from federal income taxation, with the intention and expectation that your petitioner and others would rely and act upon such representation, and would be induced thereby to further the purpose and intent of said Act by purchasing said bonds. Your petitioner had knowledge of and relied upon said representations of the defendant when he purchased said bonds of the Kansas City Joint Stock

Land Bank and of the Bankers Joint Stock Land Bank of Milwaukee, and subsequently surrendered or sold said bonds as set out above, and except that petitioner believed the defendant's representations to be true and to represent defendant's policy, he would not have purchased said bonds, as he did in reliance on said representations.

VII. Prior to March 8, 1932, your petitioner requested a ruling from the Commissioner of Internal Revenue to the effect that the income derived from said Land Bank Bonds aforesaid, was not taxable; but on or about March 8, 1932, was advised by the Deputy Commissioner of Internal Revenue that said income would be held taxable. Thereafter and within the time required by law, your petitioner filed with the Collector of Internal Revenue for the First Collection District of California, in form as provided by the Commissioner of Internal Revenue, a return of his income for 1931, and therein listed, separate and apart, the income derived from the said Land Bank Bonds as aforesaid, to-wit, the sum of $84,275.95, being the difference between the price paid for the aforesaid bonds and that received by him on the surrender and sale thereof; that he attached to said petition as a part thereof a protest in writing protesting the ruling of the Deputy Commissioner in holding said income to be taxable, and asserted that the same was exempt from taxation under the provision of Section 26 of the Farm Loan Act of 1916. A copy of the protest so

attached to said return aforesaid, is attached hereto and made a part hereof [3] as "Exhibit A".

VIII. Subsequent to the filing of your petitioner's return as aforesaid, and on or about November 13, 1933, the Internal Revenue Agent in Charge at San Francisco served on your petitioner a notice of a proposed deficiency tax based on said return and upon asserted errors therein other than that pertaining to taxation of income derived from said Farm Loan Bonds, the proposed deficiency being the sum of $3424.20; thereafter and on or about December 4, 1933, your petitioner filed a protest with said agent and a conference was held thereon on or about February 5, 1934. As a result of said conference an agreement was entered into covering all issues discussed at said conference and fixing a deficiency at $3286.34; but said agreement did not cover the issue of taxability of income derived from Federal Farm Loan Bonds, which issue was not discussed and was not agreed upon.

But for the wrongful and unlawful inclusion as taxable income for said year of the income derived from Joint Stock Land Bank bonds aforesaid in the sum of $84,275.95, your petitioner would have had no taxable income for the year 1934, even under the adjustment proposed and made as a result of the conference of February 4, 1934.

Nevertheless, and notwithstanding the fact that your petitioner had no taxable income for said year, and notwithstanding the provisions of Section

26 of the Farm Loan Act and of the covenants of said Farm Loan Bonds, and notwithstanding the representations made by the authorized agents of the United States, the Commissioner of Internal Revenue of the United States did wrongfully, erroneously and unlawfully assess, and the Collector of Internal Revenue of the United States did give notice and demand requiring your petitioner to pay, and your petitioner did pay, income tax for the year 1931 upon income derived from said bonds as aforesaid, in the amount of $4276.19, said payments being made at the following times and in the following amounts:

March	15, 1932	$ 140.16
April	15, 1932	28.32
June	15, 1932	140.16
September	15, 1932	140.16
December	15, 1932	140.21
April	16, 1934	3,687.18
Total		$4,276.19

[4]

No petition has been filed by your petitioner with the Board of Tax Appeals for redetermination or review of the deficiencies or taxes assessed against your petitioner with respect to the year 1931.

IX. Thereafter and on or about the 16th day of May, 1934, your petitioner prepared and caused to be filed with the Collector of Internal Revenue for the First Collection District of California, a duly executed claim for the refund of said income tax so erroneously assessed and collected as aforesaid, said claim being for the principal sum of

$4,107.76 (the amount paid on and after June 15, 1932). A copy of said claim as filed is attached hereto and made a part hereof, marked "Exhibit B".

X. On or about June 28, 1935, an additional statement of fact amending said claim was filed with the Bureau of Internal Revenue at San Francisco, together with a memorandum of points and authorities in support thereof. The additional statement of fact was as follows:

"Both the Kansas City Joint Stock Land Bank and the Banker's Joint Stock Land Bank, with whose bonds we are concerned, were in receivership and in process of liquidation at the time of the disposal by the taxpayer of the bonds involved herein.

"The refund in the amount of $4107.76 is claimed on the grounds:

(a) That in the return filed by the taxpayer, tax exempt income on the liquidation of the Kansas City Joint Stock Land Bank bonds were included in his taxable income for the year 1931.

(b) That in the return filed by the taxpayer, tax exempt income on the sale of Bankers' Joint Stock Land Bank bonds were included in his taxable income for the year 1931.

"During the year 1930 the taxpayer acquired bonds of the Kansas City Joint Stock Land Bank in the aggregate principal amount of $886,000.00, at a cost to him of $504,275.74. This bank, in re-

ceivership since May 4, 1927, was in process of liquidation in 1931. On June 24, 1931, the Federal Farm Loan Board authorized a liquidating dividend on all outstanding bonds of the bank aggregating $26,750,000.00; on November 20, 1931, an additional $300,128.26 was authorized. The amount of liquidating dividends received by this taxpayer was $580,636.69. [5]

"In addition to the principal par value of the bonds held by him ($886,000.00) the unpaid accrued interest at the time of the surrender of the bonds was $183,352.77; so that the total amount due on the face of the bonds and coupons was $1,069,352.77. While, therefore, the taxpayer had an income of $76,360.95 on the transaction, that being the difference between his purchase price and the amount received by him in liquidation, nevertheless the amount so received by him was less than the full amount due by some $488,716.08; and the income actually received by him was less than the interest actually due by $106,991.82.

"During the year 1930, the taxpayer also acquired bonds of the Bankers' Joint Stock Land Bank of Milwaukee in the aggregate principal amount of $90,000,00, at a cost to him of $19,335.00. At the time he sold these bonds in 1931 there was due in interest accrued thereon the sum of $16,645.83, making a total due, principal and interest of $106,645.83. He sold the bonds in 1931 for the aggregate sum of $27,250.00. While, therefore, in this case the taxpayer also had an income of $7,915.00 on the

transaction, the difference between his purchase price and the sale price, nevertheless the amount so received by him was less than the full amount due by $78,395.83, and the income actually received by him was less than the interest actually due by $8730.83."

XI. After the protest mentioned in paragraph IX had been filed by your petitioner, and as a preliminary to a ruling thereon, an examination of the books of your petitioner was made by a representative of the Internal Revenue Agent in Charge at San Francisco; and based on said examination a report to the Commissioner of Internal Revenue was duly made on or about October 26, 1934, which report recommended the elimination from net income of the income derived by petitioner from said bonds, as aforesaid, and the refund to your petitioner of the tax paid within two years prior to filing the claim, to-wit, the sum of $3706.92.

XII. That nevertheless, on or about the 9th day of June, 1937, the Commissioner of Internal Revenue mailed to your petitioner by registered mail a notice of the disallowance of said claim; a copy of said notice is [6] attached hereto and made a part hereof, marked "Exhibit C". This suit is brought within two years from the date of mailing said notice of disallowance (Sec. 1672-1673 U. S. C.).

XIII. The entire sum paid to your petitioner by the Receiver of the Kansas City Joint Stock Land Bank for the surrender of the bonds of said bank to said Receiver, including that portion of said sum

which exceeded the cost thereof, was paid under and pursuant to the covenants contained in said bonds, and was, and is, exempt from any and all forms of taxation under the provisions of Section 26 of the Federal Farm Loan Act. The income derived by your petitioner from the aforesaid bonds of the Kansas City Joint Stock Land Bank as set forth in Paragraph III supra, was, and is, income derived from said bonds within the meaning and provisions of the said Section 26 of the said Federal Farm Loan Act, and by virtue of said section was, and is, exempt from the imposition of any income tax. The imposition of a tax on said income is a violation of the covenants contained in said bonds and of the representations made by the duly authorized agents of the defendants to the general public and to this petitioner in the sale of said bonds; and contravenes the Fifth Amendment to the Constitution of the United States.

XIV. The income derived by your petitioner from the aforesaid bonds of the Bankers' Joint Stock Land Bank as set forth in Paragraph IV supra was, and is, income derived from said bonds within the meaning and provisions of Section 26 of the Federal Farm Loan Act, and by virtue thereof was, and is, exempt from the imposition of any income tax. The imposition of a tax on said income is a violation of the covenants contained in said bonds, and of the representations made by the duly authorized agents of the United States to the general public and to your petitioner in a sale of said

bonds; and contravenes the Fifth Amendment to the Constitution of the United States.

Wherefore, your petitioner prays that a judgment may be made and entered herein, adjudging that the income derived by your petitioner from the bonds of the Kansas City Joint Stock Land Bank, through their purchase and surrender to the Receiver of said bank, and from bonds of the Bankers Joint Stock Land Bank of Milwaukee through their purchase and sale, [7] is exempt from taxation by virtue of the provisions of Section 26 of the Federal Farm Loan Act and related statutes; that taxation of such income would be and is contrary to the covenants contained in said bonds and to the representations of the Treasury Department of the United States and in violation of the Fifth Amendment to the Constitution of the United States; that plaintiff herein have and recover judgment against the defendant in the sum of $4,107.76, together with interest thereon from the various dates on which the respective payments were made as provided by law, and his costs herein, and for such other and further relief as to the Court may seem proper.

Dated this 31st day of December, 1937.

W. G. HARMON,
ERNEST L. WILKINSON,
WALTER G. MOYLE,
J. EDWARD JOHNSON,
Attorneys for Petitioner,
206 Sansome Street,
San Francisco, Cal.

State of California
City and County of San Francisco—ss.

Ashby Oliver Stewart, being first duly sworn deposes and says:

That he is the petitioner named in the foregoing petition; that he has read the same and knows the contents thereof, and that the same is true of his own knowledge except as to the matters therein stated on information and belief, and as to those matters, that he believes it to be true.

ASHBY OLIVER STEWART.

Subscribed and sworn to before me this 4th day of January, 1938.

[Seal] DAISY CROTHERS WILSON,
Notary Public in and for the City and County of San Francisco, State of California.

My commission expires Aug. 14, 1941. [8]

"EXHIBIT A"

Honorable Commissioner of Internal Revenue,
Washington, D. C.

Dear Sir:

The 1931 Income Tax Return of the undersigned, A. O. Stewart, 400 Sansome Street, San Francisco, California, to which this letter is attached and forms a part of said return, has among other schedules and exhibits one captioned Schedule "C". This

Schedule "C" covers the results from the sale of real estate, stocks and bonds, shown on Page 1 of the return as Item 8.

You will note that the last four items on this Schedule "C" are preceded by a statement, making reference to telegraphic decision of the Honorable Deputy Commissioner, J. C. Wilmer, dated March 8, 1932, and that while this decision has been followed by me by including these items as taxable income, the same has been returned as taxable income under protest. The contention is that none of the last four items on this schedule are taxable income and I quote for your consideration the following authorities:

Title 12, Section 931 of the United States Code, with reference to Banks and Banking and dealing with exemption from taxation:

> ". . . First mortgages executed to Federal land banks, or to joint-stock land banks, and farm loan bonds issued under the provisions of this chapter, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal and local taxation. (July 17, 1916, c. 245, Par. 26, 39 Stat. 380.)"

1st: You will note from the above that it was the intention of the Federal Farm Loan Act to exempt all INCOME derived from these securities.

2nd: Section 22, Par. 7102, of the 1928 Act defines Gross Income, as follows:

> "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever."

There are various decisions which have been handed down from time to time, many of them being Supreme Court decisions, which have held that trading in stocks and bonds of any nature constitutes either profit or loss in the transaction. The language of the Federal Farm Loan Act is very clear as well as the Amendment of 1923 which includes Federal intermediate banks. Also the definition of Income is very clear, and I cannot see where the authority is for the decision that the income derived from these bonds is taxable, [9]

It is for this reason that I respectfully protest the inclusion of the amount of $84,275.95 profit made on these bond transactions as taxable income, and I will follow this return by a claim in abate-

ment or a claim for refund for the taxes paid on these items.

Very truly yours,

Agent for A. O. Stewart.

GTM:M [10]

"EXHIBIT B"

Form 843
Treasury Department
Internal Revenue Service
Revised June, 1930

Claim

To Be Filed with the Collector where Assessment was Made or Tax Paid.

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

Collector's Stamp (date received).

Refund on Tax Illegally Collected.

Refund of Amount Paid for Stamps unused, or used, in Error or Excess.

Abatement of Tax Assessed (not applicable to estate or income taxes.)

State of California
City and County of San Francisco—ss.

Name of Taxpayer or purchaser of stamps, A. O. Stewart.

Business address, 400 Sansome St.. San Francisco, California.

Residence, #1 18th Avenue, San Francisco, California.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed, First District of California.

2. Period (if for income tax, make separate form for each taxable year) from Jan. 1, 1931, to Dec. 31, 1931.

3. Character of assessment or tax, Income Tax, 1931.

4. Amount of assessment, $4276.19**; dates of payment, 3/15-4/30-6/15-9/15-12/15/32 and

5. Date stamps were purchased from the Government, 4/16/34.

6. Amount to be refunded, $4107.76.

7. Amount to be abated (not applicable to income or estate taxes) $.....

8. The time within which this claim may be legally filed expires, under Section 322 (a) (b) of the Revenue Act of 1932, on June 15, 1934.

The deponent verily believes that this claim should be allowed for the following reasons:

**Original Assessment	589.01
Deficiency "	3286.34
	3875.35
Interest	400.84
	4276.19

Tax Exempt Income in the sum of $84,275.95, divided equally between the taxpayer and Mary E. Stewart (his wife), was erroneously included as Taxable Income in return as filed for the calendar year 1931. Examining Agent, March 2, 1934, failed to pick up this amount and make necessary adjustment therefor.

The tax exempt income in question is detailed on Schedule "C", Profits and Losses on Sales of Real Estate, Stocks and Bonds, attached to said return and of which a copy is hereto attached for ready reference. [11]

This tax exempt income is shown in said Schedule "C" as profits on the liquidation of Kansas City Joint Stock Land Bank bonds and sale of Bankers Joint Stock Land Bank bonds, as follows:

Proceeds from	$886,000	par value	K.C.J.S.L.B.	Bonds			580636.69
Cost of	886,000	"	"	"	"		504275.74
Profit on	886,000	"	"	"	"		76360.95
Sale of	90,000	"	"	B.J.S.L.B.	"	27250.00	
Cost "	90,000	"	"	"		19335.00	
Profits on	90,000	"	"	"			7915.00
							84275.95
50% included in taxpayer's return							42137.98

Section 26 of the Federal Farm Loan Act, July 17, 1916, as amended provides in part as follows:

> "First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds, issued under the provisions of this

Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation."

The income covered by this claim is therefore tax exempt in accordance with this statute. In support of this, the taxpayer respectfully refers to the opinion handed down on April 3, 1933, in a communication from the Honorable C. M. Charest, General Counsel for the Bureau of Internal Revenue, addressed to the Honorable Deputy Commissioner J. C. Wilmer (Reference CC:1:STH in Re: Des Moines Joint Stock Land Bank, Des Moines, Iowa) in which reference is made to memorandum (IT:AR:D-4 JWH) dated July, 1932, addressed to his office. In this communication the opinion is that this income constitutes "exempt income" and, therefore, is non-taxable.

For computations of net income, taxes paid, and refund claimed, see Schedule 1-Block Adjustments, attached, also copy of Schedule "C", as attached to the original return, showing the computations of the income on the above transactions.

Signed A. O. STEWART

Sworn to and subscribed before me this 16th day of May, 1934.

DAISY CROTHERS WILSON,
Notary Public in and for the City and County of San Francisco, State of California. [12]

SCHEDULE 1—BLOCK ADJUSTMENT

Line	Income	Original Return	Examiner's Adjustments 3/2/34 Additions	Examiner's Adjustments 3/2/34 Deductions	As Adjusted by Examiner	Taxpayer's Claim for Adjustment to Examiner's Report Deductions	As Adjusted by Taxpayer
1	Salaries	3,232.20			3,232.20		3,232.20
3	Interest	45,719.02		600.00	45,119.02		45,119.02
4	" T.F.C. Bonds	19,067.69		125.00	18,942.69		18,942.69
8	Profits on Sales	25,651.90*	3,505.29		22,146.61*	84,275.95	106,422.56*
10	Dividends	62,755.48	400.00		63,155.48		63,155.48
11	Other Income	113,500.91		8,010.69	105,490.22		105,490.22
12	Total Income	218,623.40	3,905.29	8,735.69	213,793.00	84,275.95	129,517.05
	Deductions						
13	Interest Paid	133,016.39			133,016.39		133,016.39
14	Taxes Paid	1,067.61			1067.61		1,067.61
17	Contributions	550.00			550.00		550.00
18	Other Deductions	21,730.37	5,165.49	491.75	17,956.63		17,056.63
	Total Deductions	156,364.37	5,165.49	491.75	151,690.63		151,690.63
	Net Income	62,259.03	9,070.78	9,227.44	62,102.37		22,173.58*
	½—Mary W. Stewart	31,129.52			31,051.19		11,086.79*
	½—A. O. Stewart	31,129.51			31,051.18		11,086.79*
	½ of Cap. Net Loss $102,947.58 added back	—	51,473.79		51,473.79		51,473.79
		31,129.51			82,524.97		40,387.00
	Computation of Tax						
	Income Subject to Tax	31,129.51			82,524.97		40,387.00
	Less Dividends 31,377.74			31,577.74		31,577.74	
	Exemption 1,750.00	33,127.74		1,750.00	33,327.74	1.750.00	33,327.74
	Subject to Normal Tax	None			49,197.23		7,059.26
	Normal Tax at 1½%	—		4,000.00	60.00	4,000.00	60.00
	" " at 3%	—		4,000.00	120.00	3,059.26	91.78
	" " " 5%	—		41,197.23	2,059.86	—	—
	Surtax 31,129.52	970.36		82,524.97	8,339.74	40,387.00	1,852.57
	Total Tax	970.36			10,579.60		1,914.35
	Less 12½% on Cap. Net Loss	—		6,434.22		6,434.22	
	Credit 25% for Earned Net Income			80.60		80.60	
	Tax Paid at Source	381.35		189.43	6,704.25	189.43	6,704.25
	Tax Assessed	589.01			3,875.35		None
	Paid 3/15-6/15-9/15-12/15/32				589.01		589.01
					3,286.34		
	Interest to 4/15/34				400.84		
	Paid 4/16/34				3,687.18		3,687.18
	Total Payment to Date						4,276.19
	Payment 3/15/32 against which Statute of Limitation has run					140.16	
	" 4/1/32 " " " " " " "					28.27	168.43
	Claim for Refund						4,107.76

SCHEDULE "C"

PROFITS AND LOSSES ON SALES OF REAL ESTATE, STOCKS AND BONDS

		Cost	Sale	Profit	Loss	Net
	Tax Free Covenant Bonds:					
2,000	Amer. Toll Bridge Co. 8s	$ 2,005.00	$ 2,000.00	$ —	$ 5.00	
4,000	Richfield Oil Co.	3,950.00	688.00	—	3,262.00	3,267.00•
	Tax Exempt Bonds:					
15,000	Montecito Water 5s	15,000.00	15,482.85	482.85	—	
5,000	State of Oregon Vet.	4,987.50	5,062.50	75.00	—	
10,000	Santa Cruz Water	10,188.10	10,237.50	49.40	—	
10,000	Los Angeles Water 4½s	10,051.29	9,937.50	—	113.79	
10,000	Marin Mun. Water Dist.	10,201.68	10,400.00	198.32	—	
10,000	City of Knoxville, Tenn.	11,420.00	8,975.00	—	2,445.00	
10,000	City of San Antonio, Tex.	9,747.72	9,050.00	—	697.72	
10,000	City of San Francisco Water	10,074.26	10,000.00	—	74.26	2,525.20•
	Other Bonds:					
5,000	Kingdom of Italy	4,862.50	4,653.59	—	208.91	
3,000	Assoc. Oil Co.	3,000.00	3,082.50	82.50	—	
12,000	Union Ice Co.	11,950.00	12,023.69	73.69	—	52.72•
	Stocks:					
3,000	Transamerica	134,208.90	5,765.00	—	—	128,433.90•
80	So. Pac. Golden Gate "B"	1,530.32	759.09	—	—	771.23•
10	Sonoma Properties Co.	2,500.00	—	Bankrupt—no recovery.		2,500.00•
	Miscellaneous Stocks:					
	Rights of Pac. Mut. Life Ins.	—	1.30	1.30		
25	Chase National Bank	Stock Div.	2,585.05	2,585.05	—	
100	Blue Ridge Preferred	5,150.00	3,778.00	—	1,372.00	
400	Shenandoah	12,837.50	13,312.00	474.50	—	
75	Blue Ridge Preferred	3,862.50	2,829.73	—	1,032.77	
100	So. Calif. Gas Pf.	9,875.00	9,373.00	—	502.00	154.08
	Real Estate					
	Installments—Chips Is. Sales Contracts Receivable	Total Receipts Total costs these lands	11,959.78	—	—	11,959.78
	" Van Sickle Is. Sales contracts receivable	recovered in 1929	15,508.34	—	—	15,508.34
						109,927.85•
19,000	Kansas City Joint Stock Land Bank Bonds	9,265.00	10,947.95	1,682.95	—	1,682.95
420,000	" " " "	243,423.48	297,904.05	54,480.57	—	54,480.57
447,000	" " " "	251,587.26	271,784.69	20,197.43	—	20,197.43
90,000	Bankers Joint Stock Land Bank Bonds	19,335.00	27,250.00	7,915.00	—	7,915.00
		Net Loss Item 8				$25,651.90•

•Indicates red figures.

"EXHIBIT C"

Treasury Department
Washington

Jun-9 1937

Office of
Commissioner of Internal Revenue
Address Reply to
Commissioner of Internal Revenue
And Refer To
IT:E:1
BAG

Mr. A. O. Stewart,
400 Sansome Street,
San Francisco, California.

Sir:

Further reference is made to your claim for refund in the amount of $4,107.76 income taxes for the taxable year ended December 31, 1931.

The basis of the claim is that tax exempt income on the liquidation of the Kansas City Joint Stock Land Bank bonds and the sale of Bankers Joint Stock Land Bank bonds was included in your taxable income and should be eliminated as nontaxable.

The claim has been carefully considered in connection with information furnished in your protests and at a conference held in this office on September 16, 1936. As stated in office letter to you dated May 10, 1935, the Bureau holds that because a Joint Stock Land Bank is exempt from tax upon the in-

come resulting from a purchase of its own bonds, it does not follow that the profit realized by an individual from a sale of such bonds is not taxable. While the bonds and the income therefrom are by the Farm Loan Act (39 Stat. 360, amended, 41 Stat. 1454) declared nontaxable, being deemed instrumentalities of the United States, the individual owners of such bonds are not Federal agencies (see Smith v. Kansas City Title and Trust Co. et al., 255 U. S. 180), and with respect to the profits upon the sales of the bonds they stand upon the same footing as a seller of state bonds, the interest on which is exempt. (See Wilcutts v. Bunn, 282 U. S. 216, Cumulative Bulletin X-1, page 309 (year 1931)).

It was contended that liquidating dividends received by you from the receiver of the bank in exchange for the bonds were prorated between principal and accrued interest in the proportions of 83.4 percent and 16.6 percent, respectively. This matter was referred for consideration to the internal revenue agent in charge at San Francisco, California, and the accrued interest on the bonds at the date of purchase could not be accurately determined from your books and records.

Accordingly, no change has been made from the previous holding of the Bureau that the profit from the sale of bonds is taxable.

For the foregoing reasons the disallowance of your claim has been sustained. Official notice of the disallowance will be issued by registered mail in

accordance with section 1103 (a) of the Revenue Act of 1932.

A copy of this letter has been mailed to your representative, Mr. Walter G. Moyle, Earle Building, Washington, D. C., in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

Respectfully,
CHAS. T. RUSSELL,
Deputy Commissioner.
By F. L. HUDSON,
Head of Division.

Due Service by copy hereof made this 5th day of January, 1938.

FRANK J. HENNESSY,
United States Attorney.
By ESTHER B. PHILLIPS,
Assistant United States Attorney.

[Endorsed]: Filed Jan. 5, 1938. [15]

[Title of District Court and Cause.]

ANSWER

Now comes the defendant by its Attorney, Frank J. Hennessy, United States Attorney for the Northern District of California, and answers the complaint herein as follows:

I.

Defendant admits the allegations of Paragraph I of the complaint.

II.

Answering the allegations of Paragraph II of the complaint, defendant denies that the taxes referred to were erroneously or unlawfully assessed against the plaintiff, or were erroneously or unlawfully collected from the plaintiff. [16]

III.

Defendant has no information or belief upon the allegations of Paragraph III of the complaint, and because of its lack of information and belief, defendant denies each and every allegation in said paragraph.

IV.

Defendant has no information or belief upon the allegations of Paragraph IV of the complaint and because of its lack of information and belief, defendant denies each and every allegation in said paragraph.

V.

Defendant admits the allegations of Paragraph V of the complaint.

VI.

Defendant denies each and every allegation of Paragraph VI of the complaint.

VII.

Answering the allegations of Paragraph VII of the complaint, defendant has no information or belief on the allegation that the income derived by plaintiff from the bonds referred to in said para-

graph was $84,275.95, but admits that he filed a return in which said item of income was reported in the manner alleged in said paragraph. Admits the remaining allegations in Paragraph VII.

VIII.

Answering the allegations of Paragraph VIII of the complaint, defendant denies that the defendant in taxing the plaintiff for his income tax for the year 1931 acted wrongfully or unlawfully in any respect, or that the defendant taxed plaintiff on amounts as taxable income for said year which should not have been included.

Defendant admits the allegations of the first Paragraph of Paragraph VIII of the complaint beginning with line 2 to line 14, inclusive, (page 4). Defendant denies the allegations of the second Paragraph of Paragraph VIII of the complaint beginning with line 14, to line 18, inclusive (page 4).

Defendant admits that the plaintiff paid income taxes for the year 1931 upon the dates and in the amounts alleged in said paragraph, pursuant to an assessment of the defendant's Commissioner of Internal Revenue, and [17] pursuant to the notice and demand from the defendant's Collector of Internal Revenue.

Defendant admits that plaintiff has not filed petition with the Board of Tax Appeals for redetermination or review of the deficiencies assessed against plaintiff for the year 1931.

Saving for these express admissions, defendan denies the remaining allegations in Paragrapl VIII.

IX.

Answering the allegations of Paragraph IX o the complaint, defendant denies that income taxe for the year 1931 were erroneously assessed or col lected from the plaintiff.

Defendant admits the remaining allegations o Paragraph IX of the complaint.

X.

Answering the allegations of Paragraph X, de fendant admits that on or about June 28, 1935, purported amended claim was filed with the Bureau of Internal Revenue at San Francisco in the form set up in said Paragraph. Defendant denies tha said amended claim so filed was meritorious.

XI.

Answering the allegations of Paragraph XI o the complaint, defendant admits the allegations o said paragraph

Defendant denies that the report referred to i said paragraph, was a final determination or wa in any way binding upon the defendant.

XII.

Defendant admits the allegations of Paragrap XII of the complaint.

XIII.

Answering paragraph XIII of the complaint, defendant denies each and every allegation contained in said paragraph.

XIV.

Defendant denies each and every allegation of Paragraph XIV.

Wherefore Defendant prays that the complaint be dismissed, for its costs, and for such other relief as may be just.

FRANK J. HENNESSY,
United States Attorney.
ESTHER B. PHILLIPS,
Assistant United States Attorney.

[18]

United States of America,
Northern District of California—ss.

Esther B. Phillips, being first duly sworn, deposes and says:

I hold the Office of Assistant United States Attorney for the Northern District of California. I make this verification in my official capacity in behalf of the defendant, the United States of America, because the defendant is a sovereign state. I have read the foregoing answer and know its contents. It is true of my own knowledge save as to the matters therein alleged on information and belief, and as to those matters I believe it to be true.

ESTHER B. PHILLIPS.

Subscribed and sworn to before me this 4th da
of April, 1938.

[Seal] B. E. O'HARA,
Deputy Clerk, U. S. District Court, Northern Di
trict of California.

Service of the within answer by copy admitte
this 4th day of April, 1938.

W. G. HARMON,
Attorney for Plainti

[Endorsed]: Filed Apr. 5, 1938. [19]

[Title of District Court and Cause—20379-S.]

STIPULATION

It is hereby stipulated and agreed by and betwe
the parties hereto, by their respective counsel
record, that in addition to the facts alleged a
admitted to be true in the pleadings on file here
the following facts may also be considered as tr
without further proof, subject to the rights of eith
party to object on the grounds of materiality a
relevancy, and to the right of either party to int
duce further evidence not inconsistent herewith:

I.

Prior to the year 1931 petitioner for himself a
wife purchased bonds with appurtenant accrued a
unaccrued interest coupons, issued under the pro
sions of the Federal Farm Loan Act of 1916 by t
Kansas City Joint [20] Stock Land Bank, a corp

ration organized under the provisions of the Federal Farm Loan Act, in the aggregate principal amount of $886,000.00 (par value), paying therefor the purchase price of $504,275.74. In 1931 petitioner for himself and wife surrendered to the receiver of said Kansas City Joint Stock Land Bank (who was duly appointed as such receiver by the Federal Farm Loan Board pursuant to section 29 of the Federal Farm Loan Act) the aforesaid bonds and appurtenant coupons, and received from said receiver in exchange therefor the sum of $580,636.69, all of which was paid to petitioner and his wife under and pursuant to the covenants contained in said bonds.

II.

Prior to 1931 petitioner for himself and wife purchased bonds and appurtenant accrued and unaccrued interest coupons, issued under the provisions of the Federal Farm Loan Act of 1916 by the Bankers Joint Stock Land Bank of Milwaukee, a corporation organized under the provisions of the Federal Farm Loan Act, in the principal aggregate amount of $90,000.00 (par value, paying therefor the sum of $19,335.00. In 1931 petitioner for himself and wife sold said bonds and appurtenant coupons for the sum of $27,250.00.

III.

The total amount received by petitioner and his wife from the bonds surrendered to the receiver of the Kansas City Joint Stock Land Bank exceeded the total amount paid therefor by $76,360.95; the

total amount received by petitioner and his wife upon the sale of the bonds of the Bankers Joint Stock Land Bank exceeded the amount paid therefor by $7,915.00. It is the taxability to petitioner of one-half the sum total of these gains which is the matter in issue in this case.

IV.

In making his income tax return for the year 1931, the year in question, petitioner divided his income between himself and his wife pursuant to the community property law of the State of California; and petitioner and his wife filed identical separate returns. Petitioner managed all business dealings for the marital community. Petitioner was on a cash basis and [21] rendered his return for the year 1931 on that basis.

V.

A typical bond of the Kansas City Joint Stock Land Bank reads as follows:

"Joint Stock Farm Loan Bond
Act of Congress Approved July 17, 1916
And Amendments Thereto

$1,000 M182673 $1,000

The Kansas City Joint Stock Land Bank
of
Kansas City, Missouri
Is Indebted to the Bearer in the Sum of
One Thousand Dollars

This bond is payable thirty years from date of issue with interest at the rate of 5 per centum

per annum, payable semi-annually following date of issue. Both principal and interest are payable in gold or lawful money of the United States at the office of the issuing Joint Stock Land Bank, or at the office of such fiscal agent or agents as such Bank may hereafter designate. This bond is subject to redemption on any interest date after ten years from the date hereof by the payment of the principal of the bond and the unpaid accrued interest.

This bond is issued under authority of the Act of Congress approved July 17, 1916, which provides that "farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation."

This Bank is organized under Section Sixteen of the Federal Farm Loan Act, operates under the provisions thereof and is under Federal supervision.

In Witness Whereof The Kansas City Joint Stock Land Bank of Kansas City has caused this obligation to be signed by its President and attested by its Secretary under its corporate seal, and three interest coupon sheets of twenty coupons each to be attached hereto.

Coupon Bond.
Issued November 1, 1922
Redeemable After November 1, 1932.
Payable November 1, 1952
Interest Payable
May 1 and November 1

M182673

Kansas City, Missouri, Nov. 1, 1922.

WALTER CRAVENS,
President.

Attest:

J. R. HUMPHREY,
Secretary." [22]

All bonds issued under the Federal Farm Loan Act by Joint Stock Land Banks, including the bonds referred to hereinbefore, contain the same language, with appropriate changes to cover the name of issuing bank, date of issue, rate of interest, denomination and date of payment.

Dated this 15th day of July, 1938.

W. G. HARMON,
ERNEST L. WILKINSON,
Attorneys for Petitioner.
FRANK J. HENNESSY,
United States Attorney,
By ESTHER B. PHILLIPS,
Ass't U. S. Atty.,
Attorneys for Defendant.

[Endorsed]: Filed July 19, 1938. [23]

In the Southern Division of the United States District Court for the Northern District of California.

Law 20379-S

ASHBY OLIVER STEWART,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

Law 20380-S

MARY WOODS STEWART,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

W. G. HARMON,
ERNEST L. WILKINSON,
WALTER G. MOYLE,
J. EDWARD JOHNSON,
Attorneys for Petitioners,
206 Sansome Street,
San Francisco, California.

FRANK J. HENNESSY,
United States Attorney,
Attorney for Defendant,
Post Office Building,
San Francisco, California.

OPINION AND ORDER

Petitioners, husband and wife, sue under the provisions of paragraphs 5 and 20 of Sec. 41, Title 28 U. S. C., to recover income taxes paid for the year 1931, claimed to have been erroneously assessed and collected. [24]

During the year 1930 petitioners purchased farm loan bonds issued under the Federal Farm Loan Act of 1916 by two joint stock land banks, a part of which, in the following year, 1931, they surrendered to the receiver of the issuing bank for liquidation, in an amount in excess of what they had paid therefor, and the remainder of which they sold for an amount in excess of the purchasing price. The gains derived from these two transactions, aggregating over $84,000, were held by the Commissioner to constitute taxable income.

The bonds were issued under the Federal Farm Loan Act of 1916, 12 U. S. C. Sec. 931, which, among other matters, provides that farm loan bonds issued by such banks "shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation." The Revenue Act of 1928 provides that there shall be levied a tax upon all income, including "gains, profits, and income derived from salaries . . . or sales or dealings in property, whether real or personal . . ." It further directs that interest upon securities issued under the provisions of the Federal Farm Loan Act shall be exempt. In 1938 Congress provided in the

Revenue Act of that year, Sec. 817, that notwithstanding the provisions of Sec. 26 of the Federal Farm Loan Act, as to obligations issued after the date of the act, all income from such bonds, except interest, shall be included in gross income.

Prior to the purchase of the bonds in question, the Commissions of Internal Revenue had apparently uniformly held that gains from sales of such obligations was exempt income. The expressions of some of the members of Congress in discussing the bill while its passage was being considered, indicated a like belief upon their part. The evidence is [25] that Mr. Stewart, who acted also for his wife, relied upon these opinions and the language of the Act, and believed that he was purchasing securities the profit upon which, in case of sale, would result in exempt income.

In Willcuts v. Bunn, 282 U. S. 216, the court held that profit derived by an investor in municipal bonds from their sale by him at a higher price than the purchase price, is taxable as income, even though such municipal bonds and the interest therefrom are exempt. The Government relies upon this opinion as decisive of the issue presented in the present case, but it is apparent that the scope of the opinion is not broad enough to constitute an adjudication upon the question immediately confronting us. There the statute made the bond and the "interest therefrom" exempt. Here the statute makes the bond and the "income therefrom" exempt, and petitioners insist that under the express words of the

statute a profit realized from the sale of such securities is income derived from the property itself and therefore exempt. Thus the immediate question is whether the profit derived from the sale of such bonds is income derived from the bonds. Clearly it is not interest or dividends; just as clearly it represents an accretion to the value of capital which has been converted into cash. It is a growth or increment of value in the investment,—an increment of gain accruing to capital. The statute itself recognized this in including gains "derived from sales or dealings in property." Obviously the profit arises from the dealing.

In this connection the language of Chief Justice Hughes in Willcuts v. Bunn, supra, is pertinent. There he said:

> (Page 227-8) "The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds. Because the tax in question is described as an 'income tax' and the profits on sales are included in 'income,' the distinction is not lost between the nature of a tax applied to interest and that of a tax applied to gains from sales. The federal income tax acts cover taxes of different sorts. . . . The tax upon interest is levied upon the return which comes to [26] the

owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of use or disposition of the security. The tax upon profits made upon purchases and sales in an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as 'the creation of capital, industry and skill.'"

So the income made up of gain from profit realized upon sale of the bonds here involved was the result of the combination of several elements, including capital investment, and quite obviously no small degree of sagacity on the part of Mr. Stewart. In the words of the Chief Justice, the resulting gain is to be regarded as the creation of capital, industry and skill. The situation is not greatly different from that contemplated by state and federal statutes levying taxes upon transfers of estates. Such a tax is proper even though the property transferred is exempt. In the present instance Congress has seen fit to include the taxable income upon the sale of property all realized accretion in value. The fact that the investment has its form of existence in exempt securities does not alter the liability of the holder for a tax upon the profits resulting from the cooperation of various elements, contributing to one final result.

Nor do I believe that the previous administrative announcements of various Commissioners is any bar to the present action by way of estoppel or otherwise. Acquiescence, even a positive undertaking by an officer of the Government, if not authorized by Congress, does not bind the United States when it seeks to enforce a public right or assert a public interest. Wilber National Bank v. United States, 294 U. S. 120; Botany Mills v. United States, 278 U. S. 282. A mistake of law does not constitute ground for an estoppel. Mutual Life Ins. Co. v. Phinney, 178 U. S. 327; Sturm v. Boker, 150 U. S. 312. The Commissioner can not, by his mistake of law, set as naught statutes of United States. Ritter v. United States, 28 Fed.(2d) 265 (C. C. A. 3). [27]

I conclude, therefore, that the tax was properly assessed, and that petitioners' suits must fail. I adopt the foregoing as my findings of fact and conclusions of law.

Judgment will enter against petitioners in bar of their suits and for costs.

Dated: August 20th, 1938.

WALTER C. LINDLEY,
United States District Judge.

[Endorsed]: Filed Aug. 20, 1938. [28]

[Title of District Court and Cause—Nos. 20379-S and 20380-S.]

ORDER AMENDING FINDINGS OF FACT NUNC PRO TUNC

The plaintiffs herein having made and filed a written motion, within term, for the amendment of the Findings of Fact heretofore on August 20, 1938, made and filed herein, a copy of said motion having been served upon the attorneys for defendant; and the attorneys for the respective parties having stipulated that said motion be filed and submitted to the Honorable Walter C. Lindley, Judge of the United States District Court who heard said causes, for his decision thereon in his home district, the Eastern District of [29] Illinois; and the Court having read said motion, and good cause appearing for this order, it is ordered that the Opinion of the Court heretofore filed herein on August 20, 1938, and by the Court adopted as its Findings of Fact and Conclusions of Law be and the same is hereby amended by the addition of the following findings to be added thereto at the places indicated:

The following sentences to be added to paragraph 2:

> "$76.360.95 of this profit came from the bonds surrendered to the receiver of the issuing bank, all of which was paid to petitioners under and pursuant to the covenants contained in the surrendered bonds. Both banks were in receivership at the time petitioners purchased their

bonds, and neither was paying interest; the purchases were made for the prospective increment to the bonds and not for their interest."

The following paragraph to be added to precede paragraph 4:

"From the time of the passage of the Farm Loan Act in 1916, the Federal Farm Loan Board issued various circulars and bulletins to acquaint the public with the Act and with the advantages of Federal farm loan bonds. These circulars contained statements that the bonds and their income were 'free from all forms of taxation', including 'income tax and all forms of State and municipal tax of every kind and character' (Ex. 1, p. 8); that 'this exemption is complete'; that 'in addition to the exemption from State, city and local taxation the bonds are free from the normal and additional Federal income tax and need not be included in tax returns' (Ex. 2, p. 3); that these bonds were 'exempt from every form of taxation,—Federal, state or local—with the single exception of succession and inheritance taxes' (Ex. 4, p. 1); that people could buy the bonds and 'forget about the taxes on them' (Ex. 4, p. 3). Mr. Stewart, acting for both [30] petitioners, saw and studied these and other circulars, none of which negatived or restricted the language above quoted. He relied upon these statements in making his purchases, reasonably believing

he was purchasing securities the profit upon which in case of sale, would be exempt income."

Dated this 2nd day of September, 1938.

WALTER C. LINDLEY,
Judge of United States District Court.

[Endorsed]: Filed Sept. 6, 1938. [31]

In the Southern Division of the United States District Court for the Northern District of California.

No. 20379-S

ASHBY OLIVER STEWART,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

This cause having come on regularly for trial upon the 19th day of July, 1938, before the Court sitting without a Jury, W. G. Harmon, J. Edward Johnson and Ernest L. Wilkinson, Esquires, appearing as attorneys for plaintiff, and Esther B. Phillips, Assistant United States Attorney, appearing as attorney for defendant, and a stipulation of facts having been filed and evidence on behalf of plain-

tiff having been introduced and closed, and the cause having been submitted to the Court for consideration and decision, and the Court after due deliberation having rendered its decision and ordered that judgment be entered herein in favor of defendant, and for costs:

Now, therefore, by virtue of the law and by reason of the premises aforesaid, it is considered by the Court that plaintiff take nothing by this action, and that defendant go hereof without day, and that said defendant do have and recover of and from said plaintiff its costs herein expended taxed at $29.80.

Judgment entered this 20th day of August, 1938.

WALTER B. MALING,
Clerk. [32]

[Title of District Court and Cause—No. 20379-S Law and Consolidated Case, No. 20380-S Law.]

Hon. Walter C. Lindley, Judge.

TESTIMONY

Appearances:

For the Plaintiffs:
W. G. Harmon, Esq., Ernest L. Wilkinson, Esq., and J. Edward Johnson, Esq.

For the Defendant:
Miss Esther B. Phillips.

Tuesday, July 19, 1938

The Court: Stewart vs. The United States.

Mr. Harmon: If your Honor please, at this time I wish to move the admission for the purpose of this case of Mr. Ernest L. Wilkinson, a member of the Bar of the State of California, the District of Columbia and of the Supreme Court of the United States.

The Court: He may participate in the trial without further formality. [34]

Opening Statement

Mr. Harmon: If the Court please, when this case was originally set for hearing I advised the Court that it would take about two days. Since that time we have made some progress in stipulating to some of the facts, and your Honor will recall that I took it up with your Honor's secretary as to whether an argument should be heard at the conclusion of the case now or whether briefs should first be submitted. If the procedure is followed that was then indicated, and argument is deferred until briefs are submitted, I think we can consummate this trial probably in less than a day.

We believe that it will further expedite the matter if rather a full opening statement is made at this point. It will take me about twenty minutes.

The Court: All right.

Mr. Harmon: But it will be very helpful to facilitate ruling on the testimony.

There are two cases before the Court at this time, those of Mr. and Mrs. Stewart, husband and wife. The cases are identical, the petitioners having filed separate returns under the California Community Property Law for the year in question. May it now be agreed and stipulated that these cases can be consolidated for the purpose of this trial and the evidence be considered as applying to both?

Miss Phillips: So stipulated.

The Court: Very well.

Mr. Harmon: Some of the facts have been admitted by the pleadings and others have been stipulated in a stipulation which I now ask leave to file in behalf of both parties.

The Court: It may be filed.

Mr. Harmon: Briefly these admitted facts are as follows: [35]

Prior to 1931, which is the tax year in question, the petitioners purchased bonds issued under the provisions of the Federal Farm Loan Act of 1916 by the Kansas City Joint Stock Land Bank, a corporation organized under that law, the bonds being of the aggregate par value of $886,000. The petitioners paid therefor the sum of $504,275.74.

The Court: That is in 1931?

Mr. Harmon: That is prior to 1931, if your Honor please. In 1931, the tax year, the Kansas City Bank which issued these bonds was in receivership, and the petitioners surrendered those bonds to the receiver and were given in exchange $580,-

636.69, all of which was paid to them under the covenant of the bonds.

The Court: In cash?

Mr. Harmon: In cash.

Another transaction involved: Prior to 1931 the petitioners purchased bonds issued under the provisions of that same act by the Bankers Joint Stock Land Bank of Milwaukee in the aggregate principal amount of $90,000, paying therefor $19,335. In 1931, the tax year in question, the petitioners sold these bonds on the market for $27,250.

The total amount received by the petitioners from the bonds surrendered to the receiver of the Kansas City Bank exceeded the amount which the petitioners paid therefor by $76,360.95.

The total amount received by the petitioners on the other transaction in excess of what they paid was $7915, or an increment on these two transactions of $84,275.95. And it is the taxability of this sum, one-half to each of the petitioners, which is the issue in these cases.

It will be noted from the pleadings and from the stipulated facts that the difference in the transactions pertaining to the [36] bonds of these two banks is that in the one instance they were surrendered to the receiver of the issuing bank and the money received by the petitioners was paid under the covenant of the bonds; in the other instance the bonds were sold on the open market.

The face of a bond of the Kansas City Bank is copied in the stipulation as a typical example of all

Farm Loan bonds. There are differences, but the differences are not material here. All Farm Loan bonds contain this covenant, among others, and I read from the bond: "This bond is issued under the authority of the act of Congress approved July 17, 1916, which provides that Farm Loan bonds issued under the provisions of this act shall be deemed and held to be instrumentalities of the United States Government and as such they and the net income derived therefrom shall be exempt from Federal, State, municipal and local taxation."

The Court: Hasn't the Supreme Court ever passed on the question of whether the profit realized in a sale of such instruments is taxable?

Mr. Harmon: It has not under this particular statute, if your Honor please. It has ruled on this statute incidentally, but this question has never been raised in exactly this way.

The Court: A new question.

Mr. Harmon: Yes, your Honor, it is new.

Before making and filing their income tax return for the year 1931 the petitioners requested a ruling from the Commissioner of Internal Revenue to the effect that this income was not taxable. About March 8, 1932, the Commissioner ruled that the income was taxable. Whereupon, within the time required by law, the returns were duly filed with the Collector, and listed in those returns [37] was this income separate and apart from other income. At the same time they filed a protest against the ruling of the Deputy Commissioner in holding the income

taxable and inserted that the same was exempt under the provisions of Section 26 of the Farm Loan Act. The tax was duly paid in accordance with the rulings of the Commissioner and a claim was filed on May 16, 1934, asking for a refund of $4,107.76 in behalf of each taxpayer, which was the amount they had paid, within the two year period. In due course following the filing of the claim, the internal revenue agent in charge in San Francisco caused an examination of the books of the petitioners to be made, and based on that examination he made a report recommending a refund; but that recommendation was denied on June 9, 1937, whereupon these suits for refund were commenced, claiming that this money had been erroneously corrected.

At this point may I also say that it is stipulated between the parties that if the petitioners are right in their contention that this income is not taxable, each petitioner is entitled to a refund of $4,107.76, plus interest.

Miss Phillips: There is no difference between us as to the amount, your Honor; the question is one of statutory interpretation.

Mr. Harmon: We come now, then, to the principal issue in these cases. Simply stated that is: Is income derived from Farm Loan bonds, in the one instance through their surrender to the receiver of the issuing bank, and in the other instance through their sale on the market, exempt from Federal Income tax by virtue of the provisions of Sec-

tion 26 of the Farm Loan Act? It is our contention that it is exempt. [38]

Our reasons are: First, the provisions of Section 26 of the Farm Loan Act are clear and wholly lacking in ambiguity. According to their plain intent the phrase "income derived therefrom" includes capital gains derived from the bonds. That section reads as follows:

"That every federal land bank and every national farm loan association, including the capital and reserve and/or surplus therein and the income derived therefrom, shall be exempt from federal, state, municipal and local taxation, except taxes upon real estate held, purchased or taken by said bank or association under the provisions of Sections 11 and 13 of this act."

The next sentence is the particular one: "First mortgages executed to federal land banks, to joint stock land banks, and farm loan bonds issued under the provisions of this act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from federal, state, municipal and local taxation."

The word "income" at and long prior to the enactment of that statute had a well defined meaning in the minds of the investing public, in the opinions of the courts and in the enactments of the legislative branch of the government. One of the most common forms of income known consisted

of capital gains, the difference between the purchase and sales price of property.

Likewise the words "derived therefrom" had a well understood meaning.

It will be our contention that this phrase was invariably used by the Legislature and the courts to denote the capital from which any gain or income sprang, either by way of interest [39] or by way of increment or capital gain. This being true, we shall assert that it follows that, in the absence of any restrictive language in the statute, the words would certainly have such meaning.

We shall take the position that, since Congress has, by its plain language, declared the income in this case to be exempt, it is an infringement upon the prerogatives of Congress for the executive branch, simply because it needs revenue, to assert the tax here in question, and for a court to uphold the executive branch in such an attempt would be none other than judicial legislation. Congress having by express language declared the income to be exempt, we shall contend that it is not for the Treasury Department nor for this court to question the wisdom thereof and to achieve an opposite result by rewriting the statute.

If we are right in this contention that the statute is clear, there will be no need for going further; but in disallowing the claims filed, the Commissioner of Internal Revenue seeks to cast a doubt upon the meaning of the statutory language, particularly on that word "income". The theory on which he does

this is set forth in an unpublished ruling of the Assistant General Counsel of the Bureau of Internal Revenue dated February 28, 1935, a copy of which we will offer in evidence later on. In this ruling it is admitted that joint stock land banks who have purchased their own bonds and have made a capital gain thereon are not taxable by reason of Section 26 of the Act; but it is asserted in the ruling that it does not follow that a capital gain by an individual on Farm Loan bonds is exempt. The ruling admits that the bonds and the income therefrom are not taxable, since they are deemed [40] instrumentalities of the Government, but it asserts that since individuals who are owners of such bonds are not Federal agencies, they are taxable on the capital gain derived from these same instrumentalities.

It will be our position that there is only one exemption provision in the statute relating to these bonds; that in determining whether the capital gain derived from them is taxable it makes no difference whether the taxpayer be a federal agency or an individual. The assistant General Counsel, on the other hand, has given two distinct interpretations to the use of the words "income derived therefrom", and which interpretation as used in a given instance is made to depend upon the status of the derivee of the income. He says that if a land bank makes——

The Court: I have a suggestion that you do not go into an argument now as to the merits of this

question. You have told me what the issue is. Let us defer our argument about it.

Mr. Harmon: I don't want to bore your Honor with a lengthy argument.

The Court: In an opening statement an argument does not have any place. Counsel merely states what the issue is. You have stated that.

Mr. Harmon: I will hasten, if your Honor please, then, and go through the other points that we have here.

It is our contention that the Government sustain the burden of showing that there is an ambiguity in the language of this statute; and if we go into the legal tests which become pertinent only when there is an ambiguity, that those legal tests will support our interpretation rather than the present position of the Government. I refer to those tests for determining the meaning of a statute. [41]

First, we shall contend that the discriminate care with which the words were used indicates clearly an intention to include capital gains.

We shall take the position also, if your Honor please, that the legislative history of the act shows the intent to exempt capital gains; that that language in Section 26 is as wide and comprehensive an exemption as is possible, and that the early drafts of the section clearly show that Congress had in mind at the time the statute was passed dealings in these bonds and the possibility of profits.

In addition, we will show that there has been no amendment to that act through the years down to

1938, but that in 1938 the last session of the Congress did amend the act and in that amendment clearly recognized our contention to be correct as to what the law is for bonds already issued.

As a third canon, we shall contend that a comparison of this exemption statute with other exemption statutes clearly show our position to be correct, and that there is a grave danger to other exemption statutes where words similar are used if this language is construed to mean what the government claims it means.

It will be our contention that the construction of this act by those charged with its construction supports our position. In this respect we shall offer in evidence a number of bulletins and circulars by the Farm Loan Board, which is charged under the Act with the duty of advertising and popularizing the bonds. And these circulars expressly state on their face an exemption which any layman, any man in the investing public, would construe as we construe it and as the petitioners construed it when they purchased these bonds. [42]

Then, too, in the matter of administrative interpretation, there are certain rulings of the Bureau of Internal Revenue which I shall offer in evidence. One of these is known as the Des Moines opinion in 1933, in which it was ruled that the Des Moines Joint Stock Land Bank was not required to pay taxes upon gains which it had made in the purchase of and the discount of its own bonds.

Incidentally, Mr. Stewart, who is one of the petitioners here, was at that time president of the Des Monies Joint Stock Land Bank. Under that ruling, if your Honor please, which has continued in force down to date, joint stock land banks have made profits in dealing in their own bonds and in bonds of other banks, as we shall show, in excess of a hundred million dollars, all of which has been held non-taxable. As late as 1937, the spring of 1937, closing agreements were made by the Revenue Bureau with various banks upon that theory of the law.

Then, too, in 1933, an act was passed requiring these banks to liquidate. To help them liquidate a ruling was sought as to the status of the tax exemption feature on mortgages which had been issued to the banks. That ruling by the General Counsel of the Treasury Department was circulated to the banks, and by them to the investing public, and these banks, on the strength of that ruling, sold great numbers of their mortgages, many of them at a discount, and represented that that income was exempt since the exemption on mortgages stands from the same language as the exemption on bonds. This is a ruling we think that supports our position.

Then, finally, we shall rely on that 1938 statute passed in the Revenue Act where Congress had before it the Des Moines opinion and accepted it as a correct interpretation of the ex- [43] isting law, and changed the law as to future exemptions so as to exempt only interest, but limited that change,

for obvious constitutional reasons, so that the law prior to 1938 has been to exempt that income.

Then there is one other point, if your Honor please, upon which we will rely. It is that the Government is estopped to collect a tax after having first through its duly authorized agents held out that these securities were tax exempt. To support this we propose to show that the Board originally charged with administering the act under the authority of the statute represented to the public down through the years that the bonds and the income derived therefrom were exempt from tax; that the exemption was complete; that it was from all forms of taxation; that it explicitly exempted the Federal Income Tax; that the validity of the bonds and their exemption as represented had been confirmed by the opinions of the Attorney General an eminent private counsel and by the Supreme Court itself.

We shall show further that the petitioners purchased these bonds as an investment and for the possibility of their increment and not merely for interest; that A. O. Stewart, acting for both of the petitioners, read the circulars and bulletins issued by the Farm Loan Board; read the covenants of the bonds themselves, and believed in and relied on what he read as exempting increment on these bonds, and so believing and relying he entered into the transactions here in question.

Upon this showing and for the reasons outlined, if your Honor please, we shall ask for judgment by the Court.

Miss Phillips: Would your Honor like to hear a statement from me at this time?

The Court: Just as you wish, Miss Phillips. [44]

Miss Phillips: I will make it very brief.

As your Honor perceives, the main question is whether or not an income derived by profits made in the sale of bonds is exempt from taxation.

The Court: Yes.

Miss Phillips: The statute clearly exempts interest paid upon the principal of a bond, but where the individual buys bonds and sells them by dealings in the market, or by surrender of them, whether those profits are taxable.

On the last point that counsel suggested, that there is an estoppel in this case, at the appropriate time I shall object to evidence on estoppel on the ground that such an issue is not raised in the pleadings. No issue is presented upon that in the pleadings.

The Court: Will you proceed, counsel?

Miss Phillips: One question your Honor asked, whether or not the Supreme Court ever passed on such a question. We shall direct your Honor's attention to the fact that in dealings on Government bonds, such as Liberty Bonds and State and municipal bonds, the Court has ruled in the case of Willcox v. Jones, reported in 288 United States, it was ruled that income derived from dealings in bonds was not exempt even though the interest on the bond itself was exempt by appropriate or constitutional provision.

The Court: You may proceed.

Mr. Harmon: If your Honor please, I was under the impression that estoppel had been pleaded in our complaint; and if it has not been pleaded I at this time ask leave to move the Court to amend the petitions.

The Court: I don't know whether it is pleaded or not.

Mr. Harmon: I am having it checked. [45]

The Court: You may have that privilege of asking to amend after you have satisfied that in your own mind.

A. O. STEWART,

called for the plaintiffs, sworn.

The Clerk: Will you state your name to the Court, please? A. A. O. Stewart.

Direct Examination

Mr. Harmon: Q. Mr. Stewart, you are one of the petitioners in this case? A. I am.

Q. And your wife is the other petitioner?

A. She is.

Q. What is your occupation, Mr. Stewart?

A. Banking and investments.

Q. What banks are you connected with?

A. President of the Pacific Coast Joint Stock Land Bank; President of Phoenix Joint Stock Land Bank in Kansas City; chairman of the Board of Directors of the Federal Reserve Bank of San

(Testimony of A. O. Stewart.)

Francisco; and Federal Reserve Agent, Twelfth District.

Q. Have you been connected with any other joint stock land banks than those that you have mentioned?

A. I have been an officer in several different banks, including the two I have just named; and up until the time I sold the Des Moines Bank I was president of the Des Moines Bank and vice president of the Pacific Coast Joint Stock Land Bank of Salt Lake City and a director of the Pacific Coast Joint Stock Land Bank of Portland.

Q. Mr. Stewart, during and prior to the year 1931 have you purchased and sold any joint stock land bank bonds individually or as an officer for any of the corporations which you have mentioned?

A. I have acted in both capacities,—as an officer of the banks [46] in which I was interested, and I have purchased large amounts of these bonds for the banks themselves——

The Court: Q. On the open market?

A. From dealers, yes.

Mr. Harmon: Q. Were your transactions in the capacity——

The Court: He hasn't finished his answer.

Mr. Harmon: I beg your pardon.

A. And as an individual, for myself I have purchased a large number of these bonds; also for my wife and family and other corporations in which I was interested.

(Testimony of A. O. Stewart.)

Q. Did you buy these bonds or enter into these transactions as a dealer in the bonds or as an investor?

A. No, I am not a dealer; I have no dealer's license; purely as an investment and in the hope and belief that there would be an enhancement or an increment in these bonds.

Q. When did you purchase the bonds of the Kansas City Joint Stock Land Bank with which we are concerned in this case? A. In 1930.

Q. Do you remember, were they purchased at more than one time?

A. Yes, I can give you the exact dates, if I may refer to a memorandum.

Miss Phillips: No objection to referring to a memorandum.

A. In July 11, 1930, in August 11, 1930, September 1930, October 1930, and November 1930, there was a total of $894,000 par value purchased, and the amount paid for them was $479,098.13, an average of about 55 cents plus per bond per dollar.

Mr. Harmon: Q. You have stated that the total par value was four hundred ninety odd thousand?

A. No, 894,000.

Q. 894,000?

A. Of that lot, and there were others.

Q. Mr. Stewart, it has been stipulated and admitted that the [47] par value of the particular bonds concerned here is $886,000. Just to keep the

(Testimony of A. O. Stewart.)

record straight, that is the amount of bonds that you surrendered to the receiver in 1931, isn't it?

A. That is correct.

Q. $886,000? A. That is correct.

Q. Some bonds you surrendered later on?

A. Yes.

Mr. Harmon: With those we are not concerned here.

The Court: They came in another year?

Mr. Harmon: Yes.

Q. Now, do you have the dates when you purchased the bonds of the Bankers Joint Stock Land Bank? A. I have.

Q. Will you give those dates, please?

A. They were purchased in January 1930 and July 1930, August 1930, September 1930, October 1930, November 1930 and December 1930, and May 1931 $2,000.

Q. Those were the bonds that were sold by you during 1931? A. Yes.

Q. Of the Bankers Joint Stock Land Bank?

A. That is correct.

Miss Phillips: That is that Milwaukee Bank you are referring to?

Mr. Harmon: The Milwaukee Bank.

Q. Do you know whether or not these banks, or either of them, were in receivership at the time you purchased the bonds?

A. Both of the banks were in receivership.

(Testimony of A. O. Stewart.)

Q. Do you know when they went into receivership? A. In 1927.

Q. Did you buy these bonds in contemplation of receiving interest thereon or capital gain or increment?

A. The bonds were purchased flat. The banks were in receivership; they were paying no interest. I naturally purchased the bonds in the hope that there would be an increment in the value of them. [48]

Q. Mr. Stewart, are you familiar with the provisions of the Federal Farm Loan Act?

A. I am. I have read it a number of times.

Q. Are you familiar with the securities issued under that act? A. I am.

Q. When did you first become interested in the Farm Loan system and its securities?

A. Well, I have been familiar with the act from the time it was passed in 1916. I gave more intensive and active study in 1929, at which time I was approached by the officers of the American Trust Company to buy the stock of the Pacific Coast Joint Stock Land Bank, which was at that time owned by the American Trust Company.

Q. Have you made a study of the Farm Loan Act and the securities? A. I have.

Q. What has your study consisted of?

A. The reading of the act itself, and from many, many bulletins that have been put out by the Treasury Department, and from—I have also read the

(Testimony of A. O. Stewart.)

opinion of Charles Evans Hughes rendered to the Investment Bankers as to the constitutionality of the act; also the opinion of the Attorney General, and also some cases pertaining to the constitutionality of the act.

Q. Where did you get the circulars which you have mentioned?

A. From various dealers from whom I have purchased the bonds I requested that they send me circulars pertaining to the issues. I have also got a number of bulletins from the files of my own bank that were put out by the Treasury Department, and from whatever source that others were available.

Q. Did you pay any particular attention in your study to the matter of tax exemption?

Miss Phillips: At this time I object to the question as calling for testimony that is incompetent, irrelevant and immaterial. [49]

The Court: I do not think it is material, but he may answer subject to the objection. It is before the Court. Go ahead.

A. That was one of the principal inducements that led me to purchase these bonds.

Mr. Harmon: Q. Why?

A. Because of the sweeping exemption granted by the—granted in the bond itself. It was a peculiar bond of uncommon character, in that it was an instrumentality of the Government; it was not guaranteed by the Government; and I was interested in finding out why this sweeping exemption was put in

(Testimony of A. O. Stewart.)

this particular bond. In fact they are the only bonds that I know of issued by the Government or any instrumentality which exempted all of the income. The word "interest" is not used in the bond at all.

Mr. Harmon: At this time I wish to offer in evidence a photostatic copy of a document entitled: "Farm Loan Primer, Circular No. 5," issued by the Federal Farm Loan Board.

Miss Phillips: I object to the introduction of this document in evidence on the ground that it is incompetent, irrelevant and immaterial, not binding on the defendant and as not evidence properly bearing on the question involved in this case. I do not raise an objection on the ground of authenticity. This is a photostatic copy, apparently.

The Court: It may be received subject to the objection made.

(The document referred to was marked

PLAINTIFFS' EXHIBIT 1.)

[Exhibit 1 is a pamphlet issued by the Treasury Department, Federal Farm Loan Board, as Circular No. 5, revised, entitled "The Farm Loan Primer", printed by the Government Printing Office and bearing on its front cover a statement that "Here you will find in brief form answers to the questions most frequently asked about the Federal Farm Loan Act and amendments thereto."]

(Testimony of A. O. Stewart.)

Mr. Harmon: Q. I hand you what has been marked as Plaintiffs' Exhibit 1 and ask you if you have seen that before or a copy of it?

A. I have seen it before. It is a Farm Loan primer that was put out by the Treasury Department— [50] by the Farm Loan Board, a branch of the Treasury Department, to acquaint the public with the character of the investment and to induce the public to invest in these farm loan bonds.

Q. When did you first see this or a copy of it, Mr. Stewart? A. On or about 1928 or 1929.

Q. On page 8 of that exhibit I find the following language in question and answer form. I will read it to you:

> "Q. You have spoken entirely from the point of view of the farmer borrower. Suppose a person has money to invest, how does this system interest him?
>
> A. The bonds of the Federal Land banks ought to be a very attractive investment for him.
>
> "Q. Why?
>
> A. Because they are secure, command a ready market, and are free of all forms of taxation."

And then down commencing with question 75:

> "Q. You say the bonds are free of all forms of taxation. Does that include income tax and all forms of State and municipal tax of every kind and character? A. Yes.

(Testimony of A. O. Stewart.)

Q. And is the income of these bonds also free of taxation? A. Yes."

Did you read that language at the time you examined this, Mr. Stewart? A. I did.

Q. What did you understand the language to mean with reference to taxing gains derived from the bonds through their purchase and sale?

Miss Phillips: Just a moment. That is objected to as calling for the witness' statement of a conclusion of law which he drew himself.

The Court: He may answer subject to the objection. I doubt the propriety of it. [51]

Mr. Harmon: If your Honor please, it goes to the matter of estoppel.

The Court: I am letting it in subject to objection. I don't care for any comments on it now.

A. I construed it to mean that the income, from whatever source or character, pertaining to or derived from these bonds was exempt.

Mr. Harmon: Q. Did that include in your idea capital gains? A. It did.

Q. I ask you if you relied on these statements that I have just read in purchasing these bonds of the Kansas City Bank and the Bankers Joint Stock Land Bank?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: He may answer subject to the objection.

(Testimony of A. O. Stewart.)

A. Yes, I relied on those statements, together with many others in other bulletins.

Mr. Harmon: I now wish to offer in evidence a photostat of the circular dated May 15, 1918, is the proper date, issued by the Federal Farm Loan Board.

The Court: What date?

Mr. Harmon: May 15, 1918.

Miss Phillips: That is objected to as incompetent, irrelevant and immaterial. No objection made on the ground of authenticity, your Honor.

The Court: Received subject to the objection.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 2

in evidence.)

[Exhibit No. 2 is a photostatic copy of Circular No. 9, issued by the Federal Farm Loan Board of the Treasury Department, Washington, D. C., under date of May 15, 1918, pertaining to Federal land bank 5% farm loan bonds dated May 1, 1918, and due May 1, 1938. On the second page, in addition to the statement referred to hereinafter, is the following statement:]

> "These bonds are declared by the Act to be 'instrumentalities of the Government of the United States,' and as such the income therefrom are exempt from Federal, State, municipal and local taxation. This includes the Fed-

(Testimony of A. O. Stewart.)

eral income tax, and income from these bonds need not be included in income tax returns."

Mr. Harmon: Q. Mr. Stewart, have you ever seen a copy of this document marked Exhibit 2, which I now hand you? [52]

A. I have, yes.

Q. Do you remember when you first saw it?

A. It was in '28 or '29, just about the time that I purchased this bank.

Q. On the first page of this circular in caps appears these words: "Exempt from federal, state, municipal, and local taxation." On the second page in italics appear these words: "The constitutionality of the act and the validity of the provisions exempting the bonds from taxation have been approved by the Attorney General of the United States on behalf of the Government and by eminent counsel in behalf of private interests." On the third page appears this language: "Tax exemption. Free of Federal, State, city and local taxes. The act states that: 'the Farm Loan bonds issued under the provisions of this act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation.' "

And the further statement: "It will be noted that this exemption is complete, and that in addition to the exemption from State, city and local taxation,

(Testimony of A. O. Stewart.)

the bonds are free from the normal and additional Federal income tax and need not be included in income tax returns."

Do you recall having read that language before, Mr. Stewart? A. I did.

Q. What did you understand that language to mean as regards the kind of income which is in controversy here?

Miss Phillips: I make the same objection, your Honor, as I did to the previous question; it is incompetent, irrelevant and immaterial, and calls for the witness' opinion on a question of law. [53]

The Court: He may answer subject to the objection.

A. That it was—that the income was exempt.

Mr. Harmon: Q. Did you rely on those statements that I have just read in making the purchases of the bonds which are in question here?

A. I did.

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Same ruling.

Mr. Harmon: Q. This circular refers, Mr. Stewart, to opinions of the Attorney General and of eminent counsel on behalf of private interests. Did you read any of those opinions?

A. I read the opinion of Honorable Charles E. Hughes as to the constitutionality of the act and the

(Testimony of A. O. Stewart.)

continuing exemption granted under that act and also the opinion of the Attorney General.

Mr. Harmon: I wish to offer in evidence at this time a photostatic copy of that portion of the opinion of the Honorable Charles E. Hughes to which has been referred and which pertains to the tax exemption feature.

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: I may want to read it anyhow. It may be admitted subject to the objection.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 3

in evidence.)

Mr. Harmon: Q. Reading the concluding paragraph of that opinion, Mr. Stewart, as follows:

> "My conclusion is that the farm loan bonds to be issued by the Federal Land Banks organized and controlled as provided in the Federal Farm Loan Act will be, when duly issued and paid for, valid securities, constituting as de- [54] clared by Congress instrumentalities of the Government of the United States, and that they and the income derived therefrom will be exempt as provided in the Act from Federal, State, municipal and local taxation; and further that, with respect to bonds duly issued and paid for under this exemption, it will constitute a con-

(Testimony of A. O. Stewart.)

tinuing exemption which cannot be withdrawn by subsequent legislation."

You read that language, did you?

A. I did.

Q. What did you understand that language to mean with reference to the particular type of income which the Government now seeks to tax?

Miss Phillips: Objected to as calling for the witness' opinion on a question of law—a conclusion of the witness.

The Court: He may answer subject to the objection.

A. That the income derived from these bonds was exempt and that it was a continuing exemption regardless of ownership.

Mr. Harmon: Q. And did you rely on that understanding in making the purchases of bonds which are the root of this case?

Miss Phillips: Just a moment. Objected to as incompetent, irrelevant and immaterial.

The Court: Received subject to the objection.

Mr. Harmon: I now desire to offer in evidence photostatic copies of three pages of a document known as "The Borrowers' Bulletin," issued by the Federal Farm Loan Bureau of the United States Treasury Department, the first page being from an issue of June-July 1918, the second page from the issue of November 1917, and the third page from the issue of February-March 1918.

(Testimony of A. O. Stewart.)

Miss Phillips: That is objected to as incompetent, irrele- [55] vant and immaterial. I do not object to the authenticity of those pages.

The Court: Received subject to objection.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 4

in evidence.)

[Exhibit No. 4 consists of photostatic copies of three pages from a circular entitled, "The Borrower's Bulletin", issued by the Federal Farm Loan Bureau, U. S. Treasury Department, the first being from the June-July, 1918, issue, the second from the February-March, 1918 issue, and the third from the November, 1917 issue.]

Mr. Harmon: Q. Reading now from the issue of June-July 1918, I call your attention, Mr. Stewart, to this language:

> "any doubt as to the public appreciating or desiring these new bonds which are tax-free and instrumentalities of the Government has been dispelled for all time." Later on in the same article, center column: "Next to tell the investor, large and small, that Federal farm loan bonds are an excellent security, one that pays a good rate of interest and is exempt from every form of taxation—even the income from them is exempt."

(Testimony of A. O. Stewart.)

And again on the last column of that page:

> "Of added interest at this time is the fact that the Federal farm loan bonds are exempt from every form of taxation—Federal, State or local—with the single exception of succession and inheritance taxes."

Then on the first column of the page from the November 1917 issue there is this paragraph:

> "These bonds possess many attractive features as an investment for farmers. They bear an interest rate of 4½ per cent, and they are entirely free of all forms of taxation with the exception of inheritance tax. They are free from income tax. They are regarded as one of the most attractive investments ever offered in this country."

In the first column of the February-March 1918 issue are these words:

> "Buy Federal farm loan bonds and forget about the taxes on them. Neither the township, town, village, city, [56] school district, county, State or United States Government can tax them. This exemption from taxation is offered so that the farmers will no longer have to pay taxes through increased interest rate on what they owe. The income from Federal farm loan bonds is also exempt from taxation."

(Testimony of A. O. Stewart.)

Mr. Stewart, did you read these words which I have just quoted?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Received subject to the objection.

A. I did.

Mr. Harmon: Q. And what did you understand those words to mean with reference to the type of tax which the Government now seeks to assert?

Miss Phillips: Objected to as calling for the opinion of the witness on a conclusion of law; the further objection that it is incompetent, irrelevant and immaterial.

The Court: Same ruling.

A. That the income of whatever character was exempt.

Mr. Harmon: Q. Including the type here at issue?

A. Including the type at issue in this case.

Q. Did you rely on that understanding in purchasing these bonds? A. I did.

Mr. Harmon: I wish to offer in evidence a document bearing date May 1st, 1921—a photostatic copy, rather of a document bearing that date, issued by the Treasury Department.

Miss Phillips: That is objected to as incompetent, irrelevant and immaterial.

The Court: It may be received subject to the objection.

(The document referred to was marked

(Testimony of A. O. Stewart.)

PLAINTIFFS' EXHIBIT No. 5

in evidence.) [57]

[Exhibit No. 5 is a photostatic copy of Circular No. 12 issued by the Treasury Department, Federal Farm Loan Bureau, pertaining to Federal land bank 5% farm loan bonds dated May 1, 1921, and due May 1, 1941. On page 2 appears a statement, "The Supreme Court of the United States has recently passed upon and fully approved the constitutionality of the Act and the validity of the provisions exempting the bonds from taxation." On page 3 appears the following: "Tax Exemption. Free of Federal, State, City and local taxes. The Act states that: 'The farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation'. It will be noted that this exemption is complete, and that in addition to the exemption from State, city, and local taxation, the bonds are free from normal and additional Federal income tax and need not be included in income-tax returns."]

Mr. Harmon: Q. I show this document to you, Mr. Stewart, and ask you if you have ever seen this before or a copy of it? A. I have, yes.

Q. When did you see it the first time, as near as you can remember?

A. In '28—1928 or '29.

(Testimony of A. O. Stewart.)

Q. On the first page in caps are these words: "Exempt from Federal, State, municipal, and local taxation," and on the third page are these words: "Tax exemption. Free of Federal, State, City, and local taxes."

"The Act states that:" and quotes the same provision which I have quoted before, and adds this statement: "It will be noted that this exemption is complete, and that in addition to the exemption from State, city and local taxation, the bonds are free from normal and additional Federal income-tax and need not be included in income-tax returns."

Did you read those words at the time you saw this document the first time, Mr. Stewart?

A. I did.

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: He may answer subject to the objection.

Mr. Harmon: Q. And did you have the same understanding as to the meaning of those words which you have gathered from these other circulars which we have discussed?

Miss Phillips: Same objection; calling for the witness' conclusion on a question of law; the further objection that it is incompetent, irrelevant and immaterial.

The Court: He may answer subject to the objection.

A. My understanding was that there was a com-

(Testimony of A. O. Stewart.)

plete objection as to whatever income was derived from these bonds.

Mr. Harmon: Q. And did you rely on this statement along with [58] the others in making your purchase of bonds under the Federal Farm Loan Act?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Same ruling.

A. I did.

Mr. Harmon: Q. Now, Mr. Stewart, did you study any other circulars or material regarding these Farm Loan bonds?

A. Yes, I read all that I could find—could get hold of.

Q. Would you say that those that have been received in evidence are typical of the type of circulars put out by the Government?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Objection sustained.

Mr. Harmon: Q. Mr. Stewart, did you ever read in any circular or bulletin issued by the Treasury Department or any other branch of the Government anything which negatived the idea that these bonds and all income derived therefrom were exempt?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

(Testimony of A. O. Stewart.)

The Court: He may answer subject to the objection.

A. No, I have never seen anything in any of the bulletins that held otherwise than stated on the face of the bonds.

Mr. Harmon: Q. Before you purchased these bonds had you examined and read any——

Miss Phillips: Which bonds are you referring to? You say "these bonds". Which bonds?

Mr. Harmon: These bonds here in question. Had you examined and read any farm loan bonds?

[59]

Miss Phillips: Just one moment, counsel. There are two different sets of bonds. You mean referring to both of the bonds?

Mr. Harmon: I am speaking now if he has examined and read any farm loan bonds. It has been stipulated, if your Honor please, that all Farm Loan bonds are similar except for certain differences which are not material here.

Miss Phillips: Counsel's question——

The Court: Are you asking about other bonds prior to the purchase of these bonds involved?

Mr. Harmon: I am now trying to——

The Court: It doesn't make any difference if he says he read these or not; he knew what was in them and relied upon legal opinion.

Mr. Harmon: Q. I will ask you this question: Did you read any of these bonds which you purchased?

(Testimony of A. O. Stewart.)

A. Yes, I have read them over carefully.

Q. Calling your attention to this language in the bonds:

> "This bond is issued under authority of the Act of Congress approved July 17, 1916, which provides that: 'Farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States and as such, they and the income derived therefrom shall be exempt from Federal, State, Municipal, and local taxation.' "

What did you understand that language to mean as regards income through increment of the bonds such as is involved in this case?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial, calling for the witness' conclusion on a question of law. [60]

The Court: Of course, I think we are getting awfully far astray here again. I am not going to decide this lawsuit at all on what Mr. Stewart understood.

Mr. Harmon: I understand that, your Honor.

The Court: I am going to decide it on what the law means.

Mr. Harmon: That is probably the principal issue.

The Court: And he can't change it. What he believed and what he had in mind and what his interpretation may have been and what his induce-

(Testimony of A. O. Stewart.)

ment was, he can't change the law; it must stand on its own legs—on its own bottom.

Mr. Harmon: Here, if your Honor please, we come into that question of estoppel, and if——

The Court: Well, but you have got your records that create an estoppel, if there is an estoppel. Now you are going much further than that.

Mr. Harmon: We are only going to the question——

The Court: The last question is too broad, I think.

Mr. Harmon: I think we should show what the witness understood and that he relied on that language in making these purchases.

The Court. It is not a question, after all, of what he understood; it is a question of what a reasonably minded man will understand.

Mr. Harmon: That is correct. That is true.

The Court: Mr. Stewart may have wanted to read something into this in the way he understood it. We cannot test it by his understanding; we must test it by the understanding of a reasonably intelligent man reading that language and what he understood by it.

Mr. Harmon: I will withdraw the last question and reframe it this way: [61]

Q. Did you rely on the words contained in the covenant of that bond which I just read to you in making these purchases? A. I did.

(Testimony of A. O. Stewart.)

Mr. Harmon: It seems to me, if your Honor please—I have proceeded on the theory that not only must it be what a reasonable man understood from this language, but unless we can show——

The Court: That probably is a rather misleading suggestion on my part. After all, the question is the question of interpretation of law; the question of the interpretation of a contract is wholly one for the Court.

Mr. Harmon: That is true.

The Court: It doesn't make any difference whether A and B who entered into a contract understood that it meant something different from what the Court found it to mean. The question after all is what does that contract mean, and what it means is not to be determined by the parties to it but by the agency of the government that is put up here to interpret it,—that is, the court.

Mr. Harmon: I believe now that the record shows clearly enough the point that I am getting at.

The Court: Of course you have shown here—there has been admitted subject to objection—that Mr. Stewart was familiar with the language in these bonds; he knew about them; he had read these bulletins; he read the opinion of Mr. Hughes; and states that was before he purchased the bonds.

The Witness: It was, your Honor.

The Court: And you have shown that he was interested in these bonds and induced to buy them,

(Testimony of A. O. Stewart.)

probably upon the belief, acting reasonably, founded on a proper interpretation of the statute and of the bonds themselves, that he was procuring an instrument that was tax-free not only in the sense of [62] income derived therefrom but also in the sense of profit derived from the bond selling at a higher price than was paid for it. Whether he was right or wrong—and after all I have got to decide—I can't be helped very much by what he believed.

Mr. Harmon: We merely offer that to show that he did act in reliance upon this understanding.

The Court: You have shown all that. I have no idea that the Government intends to controvert that now. Have you, Miss Phillips?

Miss Phillips: I think my position on it is exactly the same as your Honor's: that after all it is a question of law: what did Congress intend.

The Court: You are not going to controvert the fact that Mr. Stewart did rely on these things as a fact? You are not going to bring in any evidence to controvert that?

Miss Phillips: I really have admitted the authenticity of these exhibits. They appear on their face to be issued by the Treasury Department.

The Court: You contend that isn't the proper interpretation. You don't intend——

Miss Phillips: I am not saying about the statement of his mind on these things——

The Court: You don't intend to introduce any evidence to contradict what he says?

(Testimony of A. O. Stewart.)

Miss Phillips: I think not, but there is one point on which I want to question him in view of this last issue of estoppel.

The Court: I am trying to limit the examination to such extent that we are not going so far afield as to be in a place alien entirely to the question we are considering.

Mr. Wilkinson: May it please the Court, our theory in asking this line of questions, from an examination of cases [63] dealing with estoppel, is just this: that in order to make out a case of estoppel it is necessary not only to show that not only acting as a reasonable and prudent man he had a right to rely upon them, but that in fact he did rely upon them.

The Court: He has testified to that. He has said that a number of times. He has been asked specifically about these specific instruments. I have permitted him to testify that he did rely on them.

Mr. Wilkinson: That is right, your Honor.

The Court: I have even permitted him to testify as to his understanding, which I think you must agree with me——

Mr. Wilkinson: We want it plain that we thought that the burden was upon us not only to prove an objective test but also a subjective test of the petitioner here. That is why we ask these particular questions.

The Court: Well, you have proved it.

(Testimony of A. O. Stewart.)

Mr. Harmon: At this time I desire to offer in evidence a typewritten copy of a document signed by the General Counsel of the Bureau of Internal Revenue dated April 3, 1933. It pertains to a ruling of the General Counsel's office in the case of the Des Moines Joint Stock Land Bank of Des Moines, Iowa, to which I alluded in my opening statement, and that portion of the exhibit which particularly we are interested in is that pertaining to the fourth issue present in that case: "Taxability of discount on taxpayer's own bonds purchased during the taxable year." There are several pages of this that do not pertain to that, and if it is——

The Court: If you offer this and it is received, you may, at your convenience, make an excerpt copy therefrom directly under quotation marks of the particular part that you desire to [64] have in the record and submit it to Miss Phillips.

Miss Phillips: This is an authentic copy of the ruling of the General Counsel's office, your Honor.

The Court: It won't be necessary to keep the whole document in evidence if you will indicate the parts that you desire to have admitted.

Mr. Harmon: We will just extract those particular pages and leave them, your Honor.

Miss Phillips: This is an authentic copy of the opinion of the General Counsel on several issues of law involved in the Des Moines Joint Stock Land Bank case. My objection to this would go not to its

(Testimony of A. O. Stewart.)

authenticity but that this is an opinion on a question of law by the General Counsel of the Bureau at that time and as being incompetent, irrelevant and immaterial; and the further ground that this opinion relates to the status of a joint stock land bank itself, which is a governmental agency, in the taxability of its own income, and not applicable to the question of the taxability of the income of an individual.

The Court: It may be received subject to the objections.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 6

in evidence.)

[Exhibit No. 6 is a copy of an opinion and ruling by the General Counsel of the Bureau of Internal Revenue under date of April 3, 1933, in a case involving the Des Moines Joint Stock Land Bank. The pertinent part of this opinion, referred to by counsel as the Des Moines opinion is as follows:]

OPINION OF GENERAL COUNSEL OF BUREAU OF INTERNAL REVENUE

Des Moines Joint Stock Land Bank

CC:I:STH

Apr 3 1933

In re: Des Moines Joint Stock Land Bank,
Des Moines, Iowa.

Deputy Commissioner Wilmer:

Reference is made to the memorandum (IT:AR:D4:JWH) dated July 19, 1932, addressed

(Testimony of A. O. Stewart.)

to the representative of this office attached to the Income Tax Unit by the head of the Audit Review Division, in which an opinion is requested as to the taxability in general of all profits on the capital and surplus of joint stock land banks.

At a hearing before this office and in brief filed on October 3, 1932, four specific issues were raised, as follows:

1. Deductibility of interest paid on outstanding loan farm loan bonds of the taxpayer in excess of interest received on first mortgages owned by the taxpayer.
2. Determination of the date when the exemption granted to income from first mortgages ceases.
3. Deductibility for income tax purposes of real estate appraisal losses taken by the taxpayer pursuant to regulations of the Federal Farm Loan Board.
4. Taxability of discount on taxpayer's own bonds purchased during the taxable year.

* * * * * * *

Issue 4

Relative to the fourth issue it appears from the facts that the taxpayer, during 1929, purchased on the open market a total of $1,144,000.00 par value of its own bonds. Of this

(Testimony of A. O. Stewart.)

amount the taxpayer cancelled and retired all but $230,000.00 par value of these bonds. The $230,000.00 par value not retired were pledged as collateral with the First National Bank of Chicago to secure notes owing to that bank in the sum of $84,425.00. For the bonds not cancelled, the taxpayer paid $139,235.00, a discount of $90,765.00.

The taxpayer contends (1) that all discount on federal farm loan bonds purchased by it is tax exempt; and (2) assuming that the discount realized on the purchase of the bonds retired is taxable, the sum of $90,765.00 was not income realized by actual retirement of bonds during that year.

Relative to the taxpayer's first contention, reference is made to Section 26 of the Federal Farm Loan Act, quoted in part under the discussion of issue two. It will be noted that the act provides that farm loan bonds *and the income derived therefrom,** shall be exempt from Federal, State, municipal and local taxation. Section 26 is cited and stated in article 85 of Regulations 74, which provides that the interest from farm-loan bonds is not subject to the income tax.

Section 22(b) (4) (B) of the Revenue Act of 1928 provides that interest upon securities

*Italics supplied.

(Testimony of A. O. Stewart.)

issued under the provisions of the Federal Farm Loan Act, or under the provisions of said Act as amended, shall be exempt from taxation.

Article 68 of Regulations 74 provides that if a corporation purchases and retires any of its own bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year. This establishes the fact that the gain from the purchase of the taxpayer's bonds constitute INCOME. See also Kirby Lumber Company v. United States (284 U. S. 1).

The United States Supreme Court, in holding unconstitutional a Massachusetts Statute taxing corporations in proportion to their income, including income from farm loan bonds, said: "Federal Farm Loan Bonds issued under authority of Chapter 245, 39 Stat. at L. 360 (July 17, 1916) U. S. C. Title 12, #641, and by #26 p. 380 Title 12, #931 are declared to be instrumentalities of the United States and both as to principal and INCOME exempt from all State taxation." (Underscoring supplied). McCallen Co. v. Massachusetts (49 Supp. Ct. Rep. 432).

The original Federal Farm Loan Act was approved on July 17, 1916. The Revenue Act of 1916 was approved on September 8, 1916, and contained among others the following provisions relative to income exempt from tax.

(Testimony of A. O. Stewart.)

Section 4:

> "Interest upon the obligations of a State or any politicial subdivision thereof or upon the obligations of the United States or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July seventeenth, nineteen hundred and sixteen."

Section 11 (a) (14)

> "Joint stock land banks as to income derived from bonds or debentures or other joint stock land banks or any Federal land bank belonging to such joint stock land banks."

The above provision appears under the head of "Conditional and other Exemptions", relating to corporations, and was eliminated in the draft of the 1918 Act. The report of the Committee on Ways and Means, in the draft of the 1918 Act, states as follows:

> "The bill makes no change in the corporations exempt from income tax."

Section 22 of the Revenue Act of 1928 includes in the term "gross income" the gains and profits derived from "sales, or dealings in property, whether real or personal."

In re Federal Land Bank of New Orleans v. Crossland (43 Supp. Ct. Rep. 385) a writ of

(Testimony of A. O. Stewart.)

mandamus was requested, to require the recording of a mortgage upon the payment of the recording fee, without the payment of an additional sum of fifteen cents for each one hundred dollars of the principal sum secured. In that case the Supreme Court held this to be a tax upon the mortgage and forbidden by the law of the United States.

The Federal Farm Loan Act as amended, contains both the words "income" and "interest". Paragraph 22 of that act specifically provides that amortization and other payments on the principal of first mortgages shall, in the case of a joint stock land bank, be applied or employed to pay off farm bonds, issued by such bank as they mature and to purchase at or below par farm loan bonds. It is apparent, therefore, that Congress recognized the fact that income might be realized through the purchase at below par of farm loan bonds.

There is no statute which exempts all income derived from state and municipal securities, similar to the Federal Farm Loan Act exemption with reference to joint stock and Federal land bank bonds. The distinction is brought out by the Supreme Court in Wilcutts v. Bunn (282 U. S. 216), which held that income derived from dealing in state and municipal securities was not exempt from Federal income tax

(Testimony of A. O. Stewart.)

since the exemptions was limited to interest therefrom.

It is important to note the distinction between the words used in granting the exemption to various other tax exempt bonds. The Federal Farm Loan Act provides that farm loan bonds "and the income derived therefrom" shall be exempt from all taxation. Other statutes authorizing the issuance of tax exempt bonds provide that such bonds shall be exempt "as to principal and interest." First Liberty Loan Act; Second Liberty Loan Act; War Finance Corporation Act; Third Liberty Loan Act; Fourth Liberty Loan Act; Victory Liberty Loan Act.

Section 26 of the Federal Farm Loan Act specifically exempts Federal land banks and national farm loan associations from Federal, State, municipal, and local taxation, except taxes upon real estate held. The exemption specifically applies to the capital and reserve or surplus and "the income derived therefrom." The words "income derived therefrom" as there used have been interpreted by the Bureau to mean any gains or profits derived from dealing in capital and reserve or surplus. In the same paragraph of the same section, farm loan bonds and the "income derived therefrom" are

(Testimony of A. O. Stewart.)

exempted. It would be inconsistent to define the words "income derived therefrom" found in the third line of section 26, to include profits or gains, while at the same time defining the same words found in the tenth line of the same section, to include only interest.

In the instant case, the bonds in question were issued by this taxpayer, and purchased by it at a discount, both under specific authority of the Federal Farm Loan Act. As a result of the purchase, the taxpayer derived income within the meaning of the Revenue Act of 1928. Kirby Lumber Company v. United States, supra. Under such circumstances, it is the opinion of this office that the income so derived, was derived from the bonds as contemplated by the Federal Farm Loan Act. It is concluded, therefore, that the discount on the taxpayers own bonds purchased during the taxable year, constitutes exempt income and is, therefore, non-taxable. It becomes unnecessary to pass upon the taxpayers' alternate contention relative to the question of bond discount.

In conclusion, it is the opinion of this office (1) that the interest paid on taxpayer's bonds in 1929, in excess of the tax-exempt interest received on first mortgages owned by the taxpayer, constitutes a proper deduction in computing taxable net income; (2) that the exemp-

(Testimony of A. O. Stewart.)

tion granted to the income from first mortgages ceases when the mortgages are converted into substitued form of collateral; (3) that the appraisals made by the Federal Farm Loan Board after the acquisition of property at foreclosure sale, in the absence of fluctuation in value between date of acquisition and date of appraisal, form a proper basis for the recognition of gain or loss; and (4) that discount on the taxpayer's own bonds purchased during the taxable year constitutes exempt income and is, therefore, non-taxable.

The administrative file is herewith returned.

C. M. CHAREST,
General Counsel,
Bureau of Internal
Revenue.

Encl. No. 69465.

Mr. Harmon: I now wish to offer in evidence a photostatic copy of a letter dated May 2d, 1933, by the Secretary of the Federal Farm Loan Bureau addressed to all joint stock land banks referring to and quoting from the ruling just admitted.

Miss Phillips: This is an authentic copy, your Honor. My objection is that it is immaterial, irrelevant and incompetent, not controlling on the defendant.

The Court: Received subject to the objection.

[65]

(Testimony of A. O. Stewart.)

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 7

in evidence.)

[Exhibit No. 7 reads as follows:]

Treasury Department
Washington
Federal Farm Loan Bureau

May 9, 1933
May 2, 1933.

JSLB 278

To all Joint Stock Land Banks:

A decision has been rendered recently by the Bureau of Internal Revenue, after a hearing before the General Counsel of the Bureau, with respect to the income tax liability of one of the joint stock land banks under the Revenue Act of 1928.

As the issues involved in the case referred to are of widespread interest to joint stock land banks, the following excerpt from the letter of the Bureau of Internal Revenue is quoted for the information of the banks:

"First: That the interest paid on your bonds in 1929 in excess of the tax-exempt interest received on first mortgages owned by you, constitutes a proper deduction in computing taxable net income.

"Second: That the exemption credited to the income from first mortgages ceases when

(Testimony of A. O. Stewart.)

the mortgages are converted into substituted forms of collateral.

"Third: That the appraisals made by the Federal Farm Loan Board after the acquisition of property at foreclosure sales, in the absence of fluctuated value between date of acquisition and date of appraisal, form a proper basis for the recognition of gain or loss.

"Fourth: That the discount on your own bonds purchased during the taxable year constitutes exempt income and is, therefore, nontaxable."

F. D. VAN SANT,
Secretary.

Mr. Harmon: Q. Mr. Stewart, are the banks which you are now an officer of members of the National Association of Joint Stock Land Banks?

A. They are, yes.

Q. Have you participated in the activities of that association?

A. I was an officer and a member of the executive committee of that association.

Q. Are you informed personally as to whether or not the Joint Stock Land Banks organized under the Farm Loan Act have dealt in their own bonds and bonds of other banks?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial, not tending to prove any of the issues in this case.

(Testimony of A. O. Stewart.)

The Court: He may answer subject to the objection.

A. I know that they have dealt in bonds of other banks, yes.

Mr. Harmon: Q. And also in their own bonds?

A. As well as their own bonds.

Q. Do you know from your own knowledge of those banks and their dealings how much, if any, profit or gain those banks have made from dealings in their own bonds and bonds of other banks?

Miss Phillips: Objected to as incompetent, irrelevant, immaterial, not tending to prove any of the issues in this case.

The Court: Objection sustained.

Mr. Harmon: If the Court please, this is preliminary to showing——

The Court: The objection is sustained, counsel.

Mr. Harmon: At this time I wish to offer in evidence photostatic copies of agreements as to final determination of tax liability made by the Commissioner of Internal Revenue [66] with seven joint stock land banks: the Pacific Coast Joint Stock Land Bank of Salt Lake City, the Pacific Coast of San Francisco, the Denver Joint Stock Land Bank of Denver, the San Antonio Joint Stock and Land Bank of San Antonio, the Phoenix Stock and Land Bank of San Antonio, the Phoenix Joint Stock and Land Bank of Kansas City, the Des Moines Joint Stock Land Bank of Des Moines, Iowa, and the Burlington Joint Stock Land Bank of Des Moines, Iowa.

Miss Phillips: For what purpose?

(Testimony of A. O. Stewart.)

The Court: What are they?

Mr. Harmon: These are closing agreements, if your Honor please, entered into under Section 606, I think, of the Revenue Act definitely closing and terminating tax liability of these banks in question on the basis of no tax due. This evidence is offered as another administrative interpretation of the Federal Farm Loan Act. We propose to show—I think we have already partially—that these banks all made capital gains, income derived from these bonds—that is, we contend it is derived from these bonds—and that the Department construed those gains as tax-free under the provisions of Section 26. That is another administrative interpretation of the Act as late as 1937. And in that connection, if your Honor please, the Courts have held that such administrative interpretations——

The Court: The rule is clear, when there has been ambiguity the administrative interpretation—the practical interpretation by the administrative department—is admissible; if there is no ambiguity it is not admissible.

Mr. Harmon: That is correct.

The Court: There is no reason for discussing the rule.

Mr. Harmon: That is the theory on which these exhibits are offered. [67]

Miss Phillips: The evidence is objected to on the ground that it is incompetent, irrelevant and immaterial; the further ground that it does not

(Testimony of A. O. Stewart.)

appear from the face of the exhibits as to whether the agreement that no tax is due, whether or not identical questions involved in this case or the taxability of gains was involved in each of these cases for the year in question.

Mr. Harmon: We shall show that, if your Honor please, from the testimony.

The Court: You had better show it first.

Mr. Harmon: Q. All right. Mr. Stewart, you heard the names of the banks which I have just mentioned to the Court in connection with these closing agreements. Do you know of your knowledge whether or not all these banks for the years in questions had gains, capital gains derived from income from these bonds—their own bonds?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Of course it calls for more than that. If these documents have any worth at all, any pertinency, it must be shown that after balancing all losses and debits and credits there was still a profit on the bonds.

Mr. Harmon: We expect to show that.

The Court: Are you going to show that by parol?

Mr. Harmon: We are going to show it by this witness' first-hand knowledge. He was an officer of several of these banks. He knows all about these closing agreements. I think it comes under the best evidence rule. If your Honor desires, Mr. Wilkinson——

(Testimony of A. O. Stewart.)

The Court: How many of those are there?

Mr. Harmon: There are seven. [68]

The Court: Were you familiar with all of those that he read, Mr. Stewart?

A. I am; yes, your Honor.

Q. Each one of them?

A. Each one of them.

Q. And the years in question?

A. And the years in question.

Q. Do you know, as a matter of fact, that there was a profit after balancing losses in the dealings in bonds in each of those institutions for the year that is shown there?

A. I know that there was a profit; yes, your Honor.

The Court: Of course, the record may show that you object to all of this.

Miss Phillips: Yes, your Honor.

The Court: It is received subject to the objection. I think in that situation the exhibits may be received in evidence subject to your objection.

(The documents referred to were marked

PLAINTIFFS' EXHIBIT No. 8

in evidence.)

[Exhibit No. 8 consists of photostatic copies of closing agreements entered into by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury on the one hand, and by seven joint stock land banks on the other hand, all

(Testimony of A. O. Stewart.)

for the year 1934, pursuant to Section 606 of the Revenue Act of 1928, determining that there was no tax liability on the part of any of said banks for said year. As to six of these banks, the Pacific Coast Joint Stock Land Bank of Salt Lake City, the Pacific Coast Joint Stock Land Bank of San Francisco, the Denver Joint Stock Land Bank, the San Antonio Joint Stock Land Bank, the Burlington Joint Stock Land Bank and the Des Moines Joint Stock Land Bank, the agreements were signed by the respective banks on June 5, 1936, and by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury, on July 23, 1936; the seventh, the Phoenix Joint Stock Land Bank, the agreement was executed by the bank on January 21, 1937, and by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury, on May 27, 1937.]

Mr. Harmon: Q. Now, Mr. Stewart, do you know the extent to which the banks, all of the banks in the Federal Farm Loan System—that is, all the joint stock land banks,—made profits in income during the last several years?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Received subject to objection.

A. I know that they did make large profits; in fact, I have computed it.

Mr. Harmon: Q. And that was dealing in their own bonds and bonds of other banks?

(Testimony of A. O. Stewart.)

A. In their own bonds and bonds of other banks. [69]

Q. You said you have computed it. Will you state what that computation was?

A. In excess of——

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Received subject to objection.

A. In excess of $100,000,000.

Mr. Harmon: Q. Do you know whether or not that income has been treated as tax-exempt by the Bureau of Internal Revenue?

A. I know that it has.

Q. Are you familiar with the legislation that was passed in 1933 pertaining to the liquidation of joint stock land banks? A. I am.

Q. Will you state what has transpired regarding liquidation of those banks since the act was passed?

A. When the New Deal went into existence they passed—Congress passed a law forcing the joint stock land banks to liquidate their affairs, as it was the purpose of the Government to put all loans through the Federal Land Banks. Pursuant to the enactment of that law we proceeded to sell our mortgages and all our bonds or buy them in the open market and liquidate our affairs.

Q. To whom were these mortgages sold?

A. To insurance companies, to banks, to private individuals, to investors.

(Testimony of A. O. Stewart.)

Miss Phillips: Your Honor, at this time I would like to move to strike from the record questions and answers relating to the new legislation and the effect of it as I did not at first perceive what the purpose of it was or the drift of it. I think it is wholly objectionable and incompetent, irrelevant and immaterial. [70]

The Court: What is the purpose?

Mr. Harmon: The purpose is simply this, if your Honor please: We propose to show from this witness that these banks were required to liquidate and pursuant——

The Court: That is a legal question.

Mr. Harmon: Yes, if your Honor please, that is true; but pursuant to that requirement they proceeded to sell mortgages to customers, whomever they could get; that many of these mortgages had to be sold at large discounts because of the condition of the real estate market; and that in order to enable the banks to dispose of those mortgages a ruling was sought of the Bureau of Internal Revenue on whether or not income derived from these mortgages was taxable.

The Court: Let us have the ruling. I am not interested in all the things that the joint stock land banks did in attempting to comply with the law in 1933.

Mr. Harmon: I offer in evidence a copy of that ruling.

(Testimony of A. O. Stewart.)

Miss Phillips: Objected to as incompetent, irrelevant and immaterial. It is an authentic copy of the particular document.

The Court: You do not question the authenticity?

Miss Phillips: I do not question its authenticity.

The Court: It may be received subject to the objection.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 9

in evidence.)

[Exhibit No. 9 reads as follows:]

Farm Credit Administration
Washington, D. C.

September 12, 1934
JSLB 368

To All Joint Stock Land Banks

Subject: Tax Exemption Provided in Section 26 of Federal Farm Loan Act Continues to Benefit of Purchasers of First Mortgages Executed to Joint Stock Land Banks.

We quote below from a letter dated September 5, 1934, addressed by the Commissioner of Internal Revenue to the General Counsel of the Farm Credit Administration:

"Receipt is acknowledged of your letter of July 9, 1934, in which you inquire whether the income derived from mortgages executed

(Testimony of A. O. Stewart.)

to joint stock land banks which have been sold by such banks to individuals is exempt from taxation.

"You state that a request for a specific ruling has been made by prospective purchasers of the mortgages in question. The ruling in I. T. 2470, C. B. VIII-1, page 69, has been interpreted by you to be applicable to income from mortgages executed to joint stock land banks as well as to income from mortgages executed to Federal land banks, but you wish to have that confirmed by this office.

"The following provisions of section 26 of the Federal Farm Loan Act of July 17, 1916, 39 Stat. 380, as amended, are pertinent:

> "'* * * First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation.'

"As stated in the ruling referred to above, THE EXEMPTION PROVIDED FOR IN SECTION 26 OF THE FEDERAL FARM LOAN ACT IS A CONTINUING EXEMPTION. The income derived from mortgages

(Testimony of A. O. Stewart.)

executed to joint stock land banks which have been sold to individuals IS, THEREFORE, EXEMPT FROM FEDERAL INCOME TAX."

SCOTT W. HOVEY,
General Counsel.
9-12-34
1270

Mr. Harmon: Q. Pursuant to that ruling, Mr. Stewart, I ask you if mortgages were sold to insurance companies, to individuals and other concerns with the representation that income in the form of a discount on those mortgages would be exempt from taxation?

Miss Phillips: Objected to as incompetent, irrelevant and [71] immaterial.

The Court: Objection sustained.

Mr. Harmon: Q. Do you know the purpose, Mr. Stewart, for which that ruling was sought?

Miss Phillips: Objected to as incompetent, irrelevant and immaterial.

The Court: Objection sustained.

Mr. Harmon: I now wish to offer in evidence a copy of the ruling of the Assistant General Counsel of the Bureau of Internal Revenue dated February 28, 1935, which is the original ruling in the particular cases upon which the claims of the petitioners are rejected.

Miss Phillips: No objection. That is an authentic copy.

(Testimony of A. O. Stewart.)

The Court: It may be received.

(The document referred to was marked

PLAINTIFFS' EXHIBIT No. 10

in evidence.)

[Exhibit No. 10 reads as follows:]

February 28, 1935

GC:I:DAH:PSG

A-280713

In re: A. O. Stewart, et ux.,
Houston, Texas.

Deputy Commissioner Russell:

Reference is made to your memorandum IT:AR:E-1:BAG, requesting an opinion whether profit realized by the above-named taxpayer in the year 1931 on the sale of bonds of joint stock land banks is subject to Federal income tax and whether a loss sustained on the sale of such bonds is deductible. You state that in claiming refunds of tax upon the profits from sale of such bonds taxpayers rely upon the opinion of this office rendered under date of April 3, 1933 in the case of the Des Moines Joint Stock Land Bank, wherein it was held that the discount on the bank's own bonds purchased by it was not taxable to it. (G. C. M. 11726, unpublished).

It does not follow, because a joint stock land bank is exempt from tax upon the income resulting from a purchase of its own bonds, that the profit realized by an individual from a sale of

(Testimony of A. O. Stewart.)

such bonds is not taxable. While the bonds and the income therefrom are by the Farm Loan Act (39 Stat. 360, amended 41 Stat. 1454) declared non-taxable being deemed "instrumentalities of the United States," the individual owners of such bonds are not "Federal agencies" (see Smith v. Kansas City Title & Trust Co. et al., 255 U. S. 180), and with respect to the profits upon sales of the bonds they stand upon the same footing as a seller of State bonds, the interest on which is exempt. Wilcutts v. Bunn, 282 U. S. 216, C. B. X-1, page 309.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel
for the Bureau of
Internal Revenue.

Mr. Harmon: You may take the witness, Miss Phillips.

Cross Examination

Miss Phillips: Q. Mr. Stewart, I understood from your testimony on direct examination that you made your investment in the Kansas City Bank during the summer and fall months of 1930, that is, beginning with July and ending November, 1930, is that correct? A. That is correct.

Q. At that time the Kansas City Bank was in receivership, was it? A. That is correct.

(Testimony of A. O. Stewart.)

Q. It had gone into the hands of a receiver about what year, do you recall? A. In 1927.

Q. And all of its interest was in arrears, was it, since 1927? A. Yes. [72]

Q. It defaulted in its interest when it first went into a receivership?

A. That is the reason it was put in receivership.

Q. Now, you say that you purchased these bonds in reliance upon the various documents which counsel has offered in evidence, beginning with Exhibits 3 and 4 and running on through. Did you actually purchase these bonds, Mr. Stewart?

A. Did I actually purchase them?

Q. Yes, actually have them in your hands?

A. Why, yes.

Q. Isn't it true that you purchased certificates of deposits of somebody else?

A. Well, a certificate of deposit, Miss Phillips, is simply a receipt for the bonds.

Q. That is what I am getting at. Counsel is attempting to prove the foundation of an estoppel. I wanted to find out just what did you buy. Beginning, you say you bought on July 11, 1930. What was the actual thing you bought on that day?

A. Well, I bought both; I bought undeposited bonds and I bought receiver's certificates, which was merely a receipt for the bonds that had been deposited with him.

Q. That is, in some of those dates which you

(Testimony of A. O. Stewart.)

have given beginning in July and ending in November you actually purchased a bond itself with coupons accrued and unaccrued attached?

A. Yes, I did.

Q. And as to those bonds you subsequently turned them into the receiver, did you?

A. I did, yes.

Q. And got a receipt. As to some others you bought from somebody else a receipt showing that that individual had deposited a bond, is that right?

A. Yes.

Q. And you accepted a certificate, a receipt, as showing or in place of the bond itself, is that right?

A. Yes; I could have taken the receipt and gone to the receiver [73] and withdrawn the bonds.

Q. But as it was you accepted a receipt. Could you give us some notion, what sort of a form was it?

Mr. Harmon: Objected to, if your Honor please, as irrelevant and immaterial and not the best evidence.

Miss Phillips: The counsel was attempting to prove the basis of an estoppel here.

The Court: Well, Mr. Stewart has testified that he bought both deposited bonds and undeposited bonds. If some of the bonds were undeposited, of course the framework for the estoppel would exist, wouldn't it, if there is any?

Miss Phillips: Yes. I doubt if there is one, but I would like to find out just what he did buy.

(Testimony of A. O. Stewart.)

The Court: Well, suppose 90 per cent of what he bought were deposited bonds and ten per cent were undeposited bonds?

Miss Phillips: Q. I would like to ask him: Have you any idea what was the percentage of deposited bonds and undeposited bonds you bought?

A. I wouldn't remember that without referring to my books. I don't even know that they would show, because we treated the certificates the same as bonds that were dealt in. They could have been withdrawn.

The Court: Q. But there were some of them undeposited bonds? A. Yes.

Q. That you bought in the open market or from private persons?

A. I would say offhand that there was at least a third.

Miss Phillips: Q. Of undeposited bonds?

A. Of undeposited bonds.

Q. And the remaining two-thirds were of certificates or receipts for a bond? A. Yes. [74]

Q. ——which had previously been deposited, is that right? A. That is correct.

The Court: I suppose that, as a matter of fact, when these liquidation proceedings were initiated there was a direction that bondholders should file their bonds with a trustee, and I suppose when they transferred this—what did you get, a transfer from the depositor of his receipt? Did he hand over his receipt to you, or was his receipt redeposited with

(Testimony of A. O. Stewart.)

the receiver and surrendered to the receiver and a new receipt issued to you?

A. No, your Honor. It just occurs to me now that what I purchased were certificates. These bonds had been deposited with a bondholder's committee, not the receiver—the bondholders' committee that had a plan—that tried to form some plan of reorganization, and that asked for a deposit of bonds. A great many of the bondholders had deposited the bonds with that committee and received a certificate, and others did not file, and those bonds were also sold in the——They sold at the same price as the protective committee's certificates did.

Q. What you bought were the bondholders' protective committee's certificates of deposit?

A. That is correct.

Q. Those were assigned to you? A. Yes.

Q. So far as deposited bonds were concerned, that was the method followed?

A. That was the method followed.

Miss Phillips: Q. If Mr. Jones had deposited his bond you would get his certificate with an assignment on it to you? A. Yes.

Q. Or an assignment in blank—how was it?

A. Well, it was usually assigned in blank.

Q. An assignment in blank? A. Yes. [75]

Q. Would you buy these bonds on an open market, on a stock exchange or through a bank or what?

A. No, they were over the counter transactions.

(Testimony of A. O. Stewart.)

The banks were in receivership; they couldn't have been traded in on the exchange.

Q. Now, with the Milwaukee Bank, what was the situation there?

A. Well, that was in the same category; it has both. They had a protective committee also.

Q. Do you mean in that case you bought certificates of deposit which a former owner had received when he deposited the bonds with the protective committee?

A. Yes, some of them were those certificates and some of them were the actual bonds.

Q. And in that case in some you got actual bonds with the accrued and unaccrued coupons attached and others you got a certificate of deposit which was signed in blank or endorsed to you, or how was it?

A. They were usually signed in blank and you could send over any one and withdraw the actual bonds if you desired.

Q. Are you an accountant, Mr. Stewart?

A. I am not, no.

Q. When you made your statement as to the profits made by these seven or eight joint stock land banks to which your counsel directed his questions in the latter part of your examination, are you relying there on the statements of an accountant as to what the profits were or were not?

A. Oh, no. There is a report that is issued quarterly by the Farm Loan Board—it is now the Farm

(Testimony of A. O. Stewart.)

Loan Credit Administration; the name was changed in '33.—that published the condition of all of these banks, the number of bonds outstanding, the number of mortgages, and by taking the quarterly statements, for [76] instance, from the first one one year to the first of the next year, you could see the number of bonds that had been retired, and by comparing that with the market on the bonds at those various times, it would give you the amount that was made by the bank.

Q. And your conclusion as to the extent of profits made by each of these banks individually to which you testified is drawn from such conclusion or report as that?

A. From that and also from talking with the presidents of the other banks that belonged to the same association we all belong to.

Q. You did not actually go ahead and audit the books of any one of these banks to see what their profit was over and above losses during the particular tax years?

A. Well, these banks—there were no losses, Miss Phillips; in the first place, all of the income of these banks is exempt. It has always been construed to be exempt.

Q. That doesn't answer my question. It is perfectly possible that a farm loan bank may make a bad investment just as any other bank, may have fire insurance not completely covering its fire losses or anything else; any bank can have losses over and

(Testimony of A. O. Stewart.)

above its profit made during a particular year. Now, you have testified that each of these banks made a profit over and above any deductable losses they may have made; that they sustained a profit on their dealings in their own bonds and bonds of other joint stock land banks which was not taxed. Now, I am asking you what is the source of your information for your testimony on that point?

A. Well, the experience of my own bank, for instance. We have paid our stockholders $300 a share; the original investment was $100, so there [77] couldn't be many losses in the bank. That was made from the purchases of the bonds at a discount.

Q. Is your testimony now that these profits are made upon the banks going into liquidation, or was it an ordinary profit made for a particular year?

A. No, these profits were made from the purchases of their bonds at 40 or 50 or 60 cents on a dollar, and that more than offset any losses that the banks sustained in having to take over real estate.

Q. What I am trying to get at is, what is the source of your information and which you have said now that it is from conversation with presidents and other banks and from your conclusions as to the data or figures given in—was it quarterly or annual reports.

A. In the quarterly reports of the Farm Loan Board.

(Testimony of A. O. Stewart.)

Miss Phillips: I think I am almost through, your Honor.

The Court: Q. The bonds of all the joint stock land banks did not sell for 40 or 50 cents on the dollar; some of them went down to 8, 9, 10 and 13.

A. That is true, your Honor.

Miss Phillips: That is all.

The Witness: Some of them went back to 109.

Mr. Harmon: That is all, if your Honor please.

Miss Phillips. Your Honor, I am not offering any testimony. Have you concluded your case?

Mr. Harmon: Yes, except that we have checked the petitions and we find that the matter of estoppel was overlooked, and we want formal leave, if your Honor please, to amend to include a proper allegation to that effect.

The Court: You may have that.

Miss Phillips: May I have the record show an objection [78] to the motion and an exception to your Honor's ruling?

The Court: Yes. Leave to amend the complaint in each case granted. When are you going to file that?

Mr. Harmon: We will try to do that just as soon as possible; within the next day or so.

The Court. Objection by the respondent. Objection overruled. The amendment may be made tomorrow morning at ten o'clock.

Miss Phillips: May I have an exception?

The Court: You may have an exception, and you may have the privilege of amending your answer, if you desire.

Miss Phillips: Thank you, your Honor. I would like to have the record to show a motion——

The Court: Have you rested now?

Mr. Harmon: Yes, your Honor.

The Court: Does the Government rest?

Miss Phillips. I am not offering any evidence. I would like to have the record show a motion for judgment for the defendant on all the issues involved in each case; a further motion for judgment for defendant on the ground that the income derived by the plaintiffs in each of these cases from the sale of, or any dealings in the bonds or the certificates of deposit in each of the joint stock land banks involved in this case on the ground that such income was taxable and was not exempt under the provisions of the law relating to securities issued under the Federal Farm Loan Act.

The Court: The motion will be taken under advisement.

Miss Phillips: Yes, your Honor.

Testimony closed.

(Cause submitted on simultaneous briefs ten days to each side, with seven days for reply briefs.)

[Endorsed]: Filed July 21, 1938. [79]

[Title of District Court and Cause—No. 20379-S.]

NOTICE OF APPEAL

Notice is hereby given that Ashby Oliver Stewart, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on August 20, 1938, and from the whole thereof.

W. GLENN HARMON
ERNEST L. WILKINSON
Attorneys for the appellant
Ashby Oliver Stewart,
206 Sansome Street,
San Francisco, Cal.

[Endorsed]: Filed Nov. 18, 1938. [80]

[Title of District Court and Cause—No. 20379-S.]

BOND ON APPEAL

Whereas a judgment was rendered August 20, 1938, denying the plaintiff herein the refund of taxes, claim for which had been made in the above entitled action as more fully set forth in the complaint therein, and

Whereas, Ashby Oliver Stewart, is dissatisfied with said judgment or order and is desirous of appealing to the Circuit Court of Appeals for the Ninth Circuit.

Now, therefore, in consideration of the premises, the undersigned Fidelity and Deposit Company of Maryland, a body corporate, duly incorporated un-

der the laws of the State of Maryland and authorized to act as Surety, under the Act of Congress approved August 13, 1894, whose principal office is located at Baltimore, State of Maryland, does hereby undertake and promise on the part of the said United States of America, that they will prosecute their said appeal to effect and answer all costs if they fail to make good their plea and appeal, not exceeding the sum of Two Hundred Fifty and no/100 ($250.00) Dollars, to which amount it acknowledges itself justly bound.

And, further, it is expressly understood and agreed that in case of a breach of any condition of the above ob- [81] ligation, the Court in the above entitled matter may, upon notice to the Fidelity and Deposit Company of Maryland, of not less than ten days, proceed summarily in the action or suit in which the same was given to ascertain the amount which said Surety is bound to pay on account of such breach and render judgment therefor against it and award execution therefor.

Dated at San Francisco, California, this 14th day of November, A. D. 1938.

[Seal] FIDELITY AND DEPOSIT COMPANY OF MARYLAND

By GUERTIN CARROLL

Attorney-in-fact

Attest:

G. KEHLENBECK

Attesting Agent

Approved this ..... day of ....., 193....

.....

District Judge.

State of California,
City and County of San Francisco—ss.

On this 14th day of November, A. D. 1938, before me, Charles H. Cunningham, a Notary Public in and for the City and County of San Francisco, residing therein, duly commissioned and sworn, personally appeared Guertin Carroll, attorney-in-fact, and G. Kehlenbeck, Agent of the Fidelity and Deposit Company of Maryland, a corporation, known to me to be the persons who executed the within instrument on behalf of the corporation therein and acknowledged to me that such corporation executed the same, and also known to me to be the persons whose names are subscribed to the within instrument as the attorney-in-fact and Agent respectively of said corporation, and they, and each of them acknowledged to me that they subscribed the name of said Fidelity and Deposit Company of Maryland thereto as principal and their own names as Attorney-in-fact and Agent respectively.

In witness whereof, I have hereunto set my hand and affixed my official seal at my office in the City and County of San Francisco the day and year first above written.

[Seal] CHARLES H. CUNNINGHAM
Notary Public in and for the City and County of San Francisco, State of California.

My Commission expires December 26th, 1938.

The premium charge for this bond is $10.00 per annum.

[Endorsed]: Filed Nov. 18, 1938. [82]

[Title of District Court and Cause—No. 20379-S.]

STIPULATION DESIGNATING THE RECORD ON APPEAL

The plaintiff above named having taken an appeal to the United State Court of Appeals for the Ninth Circuit from the judgment entered herein, and it being the desire of the parties at this time to agree to the parts of the record, proceedings and evidence to be included in the record on appeal,

It is hereby stipulated and agreed that the record on appeal shall consist of the following:

1. The petition of the plaintiff Ashby Oliver Stewart.
2. The answer of the defendant United States of America.
3. The stipulation of facts.
4. Reporter's transcript of the evidence taken at the trial.
5. The opinion of the trial court, which was adopted by the court as findings of fact and conclusions of law; together with the direction for the entry of judgment contained therein.
6. Order of the court amending the findings of fact nunc pro tunc. [83]
7. The judgment entered herein.
8. The notice of appeal filed November 18, 1938.
9. This stipulation.
10. Order transmitting all original exhibits to the Clerk of the Circuit Court of Appeals for the Ninth Circuit, there to be held by him for use in connection with said appeal.

11. The original exhibits filed herein, it being hereby stipulated that all such original exhibits shall be transmitted to the Clerk of the United *States Court* of Appeals for the Ninth Circuit with proper certification thereon by the clerk of this Court, said exhibits to be used on the appeal herein.

Dated at San Francisco, California, December 30, 1938.

W. G. HARMON
ERNEST L. WILKINSON
Attorneys for Plaintiff-Appellant
FRANK J. HENNESSY
By ESTHER B. PHILLIPS
Attorneys for Defendant-Appellee

[Endorsed]: Filed Feb. 3, 1939. [84]

[Title of District Court and Cause—No. 20379-S.]

ORDER TO TRANSMIT ORIGINAL EXHIBITS TO CIRCUIT COURT OF APPEALS

Upon reading the stipulation of the parties hereto designating the record on appeal, and good cause appearing for this order,

It is ordered that the Clerk of this Court transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit with proper certification, all of the original exhibits offered and

received in the within cause, the same to be used on the appeal of said cause.

Dated this 3rd day of February, 1939.

A. F. ST. SURE
United States District Judge

[Endorsed]: Filed Feb. 3, 1939. [85]

[Title of District Court and Cause—No. 20379-S.]

STIPULATION

It is hereby stipulated and agreed by and between the attorneys for the respective parties hereto that the time for preparing the record in the above entitled cause and the filing and docketing the action with the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit be extended to and including the 10th day of February, 1939.

Dated: San Francisco, California, January 3, 1939.

W. G. HARMON
ERNEST L. WILKINSON
Attorneys for Plaintiffs-Appellants
FRANK J. HENNESSY
Attorneys for Defendants-Appellees

Upon reading the foregoing stipulation, it is ordered that the same be approved and that the time for preparing the record and filing and docketing

the said cause with the Circuit Court of Appeals for the Ninth Circuit be and it is hereby extended to and including February 10th, 1939.

Dated: San Francisco, California, January 3rd, 1939.

A. F. ST. SURE

District Judge

[Endorsed]: Filed Jan. 3, 1939. [86]

[Title of District Court.]

CERTIFICATE OF CLERK TO TRANSCRIPT OF RECORD ON APPEAL

I, Walter B. Maling, Clerk of the United States District Court, for the Northern District of California, do hereby certify that the foregoing 86 pages, numbered from 1 to 86, inclusive, contain a full, true, and correct transcript of the records and proceedings in the case of Ashby Oliver Stewart, vs. United States of America, No. 20379-S, as the same now remain on file and of record in my office.

I further certify that the cost of preparing and certifying the foregoing transcript of record on appeal is the sum of $12.90, and that the said amount has been paid to me by the Attorneys for the appellant herein.

In witness whereof, I have hereunto set my hand and affixed the seal of said District Court, this 10th day of February, A. D. 1939.

[Seal] WALTER B. MALING,
Clerk.

C. C. EVENSEN,
Deputy Clerk.

[87]

[Endorsed]: No. 9100. United States Circuit Court of Appeals for the Ninth Circuit. Ashby Oliver Stewart, Appellant, vs. United States of America, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed February 10, 1939.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals for The Ninth Circuit

No. 9100

ASHBY OLIVER STEWART,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

STATEMENT OF POINTS RELIED ON BY APPELLANT ON APPEAL

Comes now the appellant herein, and, pursuant to rule 19, files the following statement of the points upon which he will rely on appeal, and does hereby designate the entire record as being necessary, in his opinion, for the proper consideration of said points.

I. The gains here involved were income derived from Federal farm loan bonds, and as such, exempt from income tax by virtue of the provisions of Section 26 of the Federal Farm Loan Act.

A. The intent of Congress governs as to the tax exemption claimed; and the trial court erred in substituting therefor certain language found in Willcuts v. Bunn, 282 U. S. 216, and in holding that Section 26 was inapplicable because the tax asserted was an excise on "profits from the dealings" or on a "combination of capital, skill and sagacity."

B. The phrase, "income derived therefrom", as understood in ordinary speech, as previously used by Congress, and as construed by judicial decisions, comprehends gains of the type here involved; and Congress in enacting Section 26 is presumed to have employed such meaning.

C. The legislative history of the Federal Farm Loan Act shows Congress intended by Section 26 to exempt gains of the type here involved.

D. Section 26 has been consistently and repeatedly construed by the proper administrative officials to include gains of the type here involved.

E. The well settled administrative construction of Section 26 to the effect that it comprehended gains of the type here involved, has been relied on by taxpayer, and has been accepted and codified by Congress as the law of the land, and is binding.

F. Section 817 of the Revenue Act of 1938, the first and only amendment of Section 26, establishes that the gains here involved are derived from the bonds within the meaning of Section 26.

II. Section 26 of the Federal Farm Loan Act, and not the Revenue Act of 1928, governs the tax exemption here involved.

A. Until the Revenue Act of 1938, there was no express repeal or amendment of Section 26 of the Farm Loan Act.

B. Neither the Revenue Act of 1928 nor earlier revenue acts repealed or amended Section 26 by implication.

C. Well settled administrative construction recognizes that no revenue act (until 1938) amended or superseded Section 26.

D. The aforesaid administrative construction has been relied on by taxpayer and has been accepted and codified by Congress and is therefore binding.

E. Section 817 of the Revenue Act of 1938 conclusively establishes that previous revenue acts have not modified Section 26.

III. The appellee is estopped to assert the tax here involved.

IV. The trial court should have entered judgment against the appellee and in favor of the appellant.

Dated at San Francisco, California, this 9th day of February, 1939.

W. G. HARMON
ERNEST L. WILKINSON
Attorneys for Appellant.

Copy of foregoing statement of points received this 10th day of February, 1939.

FRANK J. HENNESSY
United States Attorney,
ESTHER B. PHILLIPS
Assistant U. S. Attorney,
Attorneys for Appellee.

[Endorsed]: Filed Feb. 10, 1939. Paul P. O'Brien, Clerk.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

Excerpt from Proceedings of Wednesday, May 10, 1939

Before GARRECHT, HANEY, and STEPHENS, Circuit Judges

Order of submission

Ordered appeal in above cause argued by Mr. W. Glenn Harmon, counsel for appellant, and by Mr. Joseph M. Jones, Special Assistant to the Attorney General, counsel for appellee, and submitted to the court for consideration and decision.

Excerpts from Proceedings of Wednesday, August 30, 1939

Before GARRECHT, HANEY, and STEPHENS, Circuit Judges

Order directing filing of opinion and filing and recording of judgment

By direction of the Court, ordered that the typewritten opinion this day rendered by this court in above cause be forthwith filed by the clerk, and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion rendered.

In the United States Circuit Court of Appeals for the Ninth Circuit
No. 9100. Aug. 30, 1939
ASHBY OLIVER STEWART, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division

Before GARRECHT, HANEY, and STEPHENS, Circuit Judges

GARRECHT, Circuit Judge.

During the year 1930 the appellant purchased bonds of the Kansas City Joint Stock Land Bank, issued under the provisions of the Federal Farm Loan Act of 1916, for the sum of $504,275.74. These bonds were of the par value of $886,000, and bore accrued and unaccrued interest coupons. In 1931 the appellant surrendered the said bonds to the receiver of the Kansas City Joint Stock Land Bank and received therefor the sum of $580,636.69.

Prior to 1931 the appellant purchased bonds, with interest coupons

attached, of the Bankers Joint Stock Lank Bank of Milwaukee, issued under the provisions of the said Federal Farm Loan Act, of the par value of $90,000, paying therefor the sum of $19,335. In 1931 the appellant sold said bonds for $27,250.

The total amount received by the appellant from the bonds surrendered to the receiver of the Kansas City Joint Stock Land Bank exceeded the total amount paid therefor by $76,360.95; the total amount received by petitioner and his wife upon the sale of the bonds of the Bankers Joint Stock Land Bank exceeded the amount paid therefor by $7,915. Both banks were in receivership at the time the appellant purchased the bonds and neither was paying interest. The purchases were made for the prospective increment and not for their interest.

From the time of the passage of the Farm Loan Act in 1916, the Federal Farm Land Board issued various circulars and bulletins to acquaint the public with the Act and with the advantages of Federal farm loan bonds, which contained statements that the bonds and their income were "free from all forms of taxation," including "income tax and all forms of State and municipal tax of every kind and character," etc. Mr. Stewart, acting for himself and his wife, saw and studied these and other circulars, none of which negatived or restricted the language above quoted. He relied upon these statements in making his purchases, reasonably believing he was purchasing securities the profit upon which in case of sale, would be exempt income.

In making his income tax return for the year 1931, the year in question, Stewart divided his income between himself and his wife pursuant to the community property law of the state of California. Identical returns were filed. The appellant managed all business dealings for the community.

Prior to filing income tax returns for 1931, appellant sought a ruling from the Commissioner of Internal Revenue that the income so derived from these bonds was exempt income. The Commissioner ruled it was taxable income and appellant included it in the returns, but simultaneously filed a protest. The appellant paid the tax and made claim for refund, which was rejected.

Complaint for refund of the income tax allegedly erroneously assessed against the appellant was filed in the court below (28 U. S. C. A. § 41 (5) and 20)); judgment was entered in favor of defendant, from which this appeal is taken. The opinion of the court below is reported in 24 F. Supp. 145.

The question presented by this appeal is whether the gain realized upon the surrender and sale of the bonds involved herein is exempt from federal income taxation by reason of Section 26 of the Farm Loan Act of 1916 (39 Stat. 360, 380). As heretofore noted, the bonds in question were issued under the provisions of the Federal Farm Loan Act of 1916, section 26 of which reads in part as follows:

"That every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the

income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the *income derived therefrom* shall be exempt from Federal, State, municipal, and local taxation." [Italics supplied.]

The bonds referred to recited:

"This bond is issued under the authority of the Act of Congress approved July 17, 1916, which provides that 'farm loan bonds issued under the provisions of this Act shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal and local taxation.'"

The applicable provisions of the Revenue Act of 1928, under which the tax complained of was assessed, are set forth in the margin,[1] as is a pertinent provision of the Revenue Act of 1938.

The appellant contends that the gains realized were exempt from income tax by virtue of Section 26 of the Federal Farm Loan Act of 1916, falling within the phrase "income derived therefrom" used in the said section of the Act, and as the word "income" is construed and defined by judicial decisions; that Section 26 was not amended or superseded by the Revenue Act of 1928 or prior revenue laws; that no revenue act until 1938 amended or superseded section 26 of the Act of July 17, 1916.

The appellee argues that gain derived from dealings in bonds is not income derived from the bonds; that the Revenue Act of 1928 exempts from taxation only the interest paid on such bonds; and that the decision of the Supreme Court of the United States in Willcuts v. Bunn, 282 U. S. 216 is controlling. On this case the decision of the court below is based.

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[1] 45 Stat. 791, 797–798.
"Sec. 22. Gross Income.
"(a) General definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
"(b) Exclusions from gross income.—The following items shall not be included in gross income and shall be exempt from taxation under this title:
* * * * * * *
"(4) Tax-free interest.—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions. * * *"
52 Stat. 447, 578 (1938):
"Sec. 817. Income from obligations and mortgages issued by joint-stock land banks.
"Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, all income, except interest, derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation."

The taxpayer is before us claiming an exemption. The rule is that an exemption from taxation is an extraordinary grace of the sovereign and a taxpayer claiming an exemption or deduction must be able to point to an applicable statute and show that he comes within its terms. White, et al. v. U. S., 305 U. S. 281, 292; New Colonial Ice Co. v. Helvering, 292 U. S. 435, 440; Cornell v. Coyne, 192 U. S. 418, 431; Dodge v. Comm'r of Corps. and Taxation (Mass.), 174 N. E. 109, 111. Section 26 of the Farm Loan Act of 1916, supra, relied upon by the taxpayer, specifically states that Federal Farm Loan Bonds "and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation." "'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, * * *." Eisner v. Macomber, 252 U. S. 189, 207. See Doyle v. Mitchell Brothers Co., 247 U. S. 179, 185; Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509, 519–520; Taft v. Bowers, 278 U. S. 470, 481; MacLaughlin v. Alliance Ins. Co., 286 U. S. 244, 249. It thus clearly appears that "income" includes both interest and gain realized through dealing in bonds or other property. See Magill, Taxable Income (1936), pp. 17, 70.

In the absence of indication of contrary intention, it is to be assumed that the legislative body gave to the word "income" the common, every-day meaning which the word has been given in the decisions above noted. If the Congress meant "interest," we are confident that word would have been used. The word "interest" is used in Section 22 of the Act not less than 6 times; the same section speaks of the purchase of farm loan bonds at below par, while Section 27 permits Federal Reserve and member banks to buy and sell farm loan bonds. The first sentence of Section 26 exempts every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom from Federal, State, etc., taxes, while the second sentence includes the exemption of bonds, such as those here involved, and the income derived therefrom in the exemption. (The Section is set out supra.) The General Counsel of the Bureau of Internal Revenue rendered an opinion under date of April 3, 1933, in a case involving the Des Moines Joint Stock Land Bank, in the course of which he said: "It would be inconsistent to define the words 'income derived therefrom' found in the third line of section 26, to include profits or gains, while at the same time defining the same words found in the tenth line of the same section, to include only interest." [Tr. 92, Pl. Ex. #6] That reasoning continues sound.

The tax was assessed under the Revenue Act of 1928, which was broad enough to include the tax in question if Section 26 was not controlling (Superintendent v. Commissioner, 295 U. S. 418, 420), and it therefore becomes of importance to inquire whether that act repealed or superseded Section 26 in any manner and, if so, to what extent. Section 22 of the Revenue Act of 1928, heretofore set forth,

provides in subdivision (a) thereof, that "'Gross income' includes gains, profits, and income derived from * * * dealings in property whether real or personal, growing out of the ownership or use of or interest in such property; * * * ." Subdivision (b) (4) of said Section 22 provides, among other things that interest upon "securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended," "shall not be included in gross income and shall be exempt from" income taxation.

There is nothing in Section 22 of the Revenue Act of 1928, so far as is apparent or has been pointed out to us, which indicates an intention on the part of the Congress to repeal or supersede Section 26 of the Farm Loan Act. The Revenue Act of 1928 is a general taxing statute designed to apply generally to the whole field, while the particular sentence of Section 26 of the Farm Loan Act, with which we are concerned, applies specifically to the income derived from farm loan bonds. According to correct rules of statutory construction, the general is not held to supersede the specific in the absence of a definite, expressed intention. No such intent is here expressed. "The cardinal rule is that repeals by implication are not favored." Posadas v. National City Bank, 296 U. S. 497, 503. See also Southeastern Alaska Mining Corp. v. Zavodsky, 9 cir., 60 F. (2d) 24, 25.

"It is a canon of statutory construction that a later statute, general in its terms and not expressly repealing a prior special statute, will ordinarily not affect the special provisions of such earlier statute. In other words, where there are two statutes, the earlier special and the later general—the terms of the general broad enough to include the matter provided for in the special—the fact that the one is special and the other is general creates a presumption that the special is to be considered as remaining an exception to the general, and the general will not be understood as repealing the special, unless a repeal is expressly named, or unless the provisions of the general are manifestly inconsistent with those of the special." Rodgers v. United States, 185 U. S. 83, 87–88. See also Movius v. Arthur, 95 U. S. 144, 146. There is here no irreconcilable conflict; both statutes may be enforced without violence to either. Red Rock v. Henry, 106 U. S. 596, 601–602; Graham & Foster v. Goodcell, 282 U. S. 409, 425–426. "Where both acts are affirmative, and the substance such that both may stand together, both are held to be in force." United States v. Gillis, 95 U. S. 407, 416.

Then, too, we must take into consideration the administrative interpretation, as evidenced by the opinion of the General Counsel of the Bureau of Internal Revenue April 3, 1933, in the Des Moines Joint Stock Land Bank matter, mentioned above, in which he states his conclusion that "income derived therefrom" includes profits or gains.

Moreover, we have the Congress, by Section 817 of the Revenue Act of 1938 (52 Stat. 447, 578), expressly repealing or amending Section 26 of the Farm Loan Act by declaring that "all income, except interest derived" from such bonds, shall be included in gross income.

If such income was taxable despite Section 26 prior to the Revenue Act of 1938, what was the reason for Section 817 of the latter act? The answer is obvious—under the statutes that income was theretofore exempt. Cf. Brewster v. Gage, 280 U. S. 327, 337. In this Section 817 the Congress said what it could have said in 1916 or in 1928, or any year, but did not. The enactment of the act in 1938 was no idle gesture but was necessary to change the proper construction of the law as it stood prior thereto.[3] "This was the explicit and intelligible declaration to which the public was entitled . . . ." when the Congress decided to terminate the exemption theretofore granted. State v. Stoll, 84 U. S. 425, 436. This was the specific amendment or repeal of Section 26 and the attempt to argue that the same result had already been accomplished by the Revenue Act of 1928 is futile.

Satisfied that Section 26 of the Farm Loan Act of 1916 provided for the exemption here claimed and that it was not repealed, amended or superseded by the Revenue Act of 1928, but continued applicable to gains of the type here in question until withdrawn by Section 817 of the Revenue Act of 1938, we pass now to a consideration of the decision of the Supreme Court of the United States in Willcuts v. Bunn, 282 U. S. 216, upon which rested the decision of the court below, and, as well, the argument of the appellee. We would feel constrained to follow the rule of Willcuts v. Bunn, supra, were it not for the difference with respect to facts which requires us to distinguish the instant case from the Willcuts case. To illustrate: In 1919 and 1920 Bunn purchased for cash, as investments, bonds issued by various counties and cities in the state of Minnesota, selling them in January, 1924, and realizing a profit thereon. The Commissioner assessed an income tax upon this net profit, which Bunn paid under protest, later claimed a refund upon the ground that the tax was illegal because assessed upon income from municipal bonds. The claim was rejected and suit brought against the Collector. Demurrer to the complaint was overruled and, defendant having declined to plead further, judgment was entered for plaintiff. The Circuit Court of Appeals affirmed and the Supreme Court granted certiorari. The Supreme Court said at pp. 223, 224, 227, and 228:

"The Revenue Act of 1924 * * * clearly authorized the tax. The Act included in the term 'gross income' the gains and profits derived from 'sales, or dealings in property, whether real or personal.' * * * The Act gave an express exemption to 'interest upon the obligation of a State, Territory or any political subdivision thereof,' but this exemption was not extended to profits realized on the sale of such obligations, * * *

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[3] "This section subjects to Federal income taxation the capital gain realized by a joint-stock land bank on the purchase of its own obligations or of mortgages made by it. It has been brought to the attention of the committee that these banks have been purchasing their own bonds at below par and issuing new bonds at or above par. Gain realized on such a purchase is, under the law, taxable income and in the case of an ordinary corporation, is taxed. Under the Federal Farm Loan Act, however, which governs the taxability of obligations of joint-stock land banks, such income is exempt. The committee is of the opinion that such income ought to be taxed. A similar situation exists with respect to mortgages issued by such banks and acquired at less than cost. For constitutional reasons the provision is confined to gain realized upon bonds and mortgages issued after and acquired after the date of the enactment of the bill." Report of Senate Finance Committee, p. 47.

"The aut[illegible]ority of the Congress to lay a tax on the profit realized by an investor from the sale or conversion of capital assets in general is not open to dispute and is not disputed. * * * The question raised here is not because the securities sold were capital assets but because they were governmental in character.

"* * * The present case is simply one of profit obtained from purchase and sale *without qualification by any special circumstance.* [Italics supplied.]

* * * * * * *

"But it does not follow, because a tax on the interest payable on state and municipal bonds is a tax on the bonds and therefore forbidden, that the Congress cannot impose a non-discriminatory excise tax upon the profits derived from the sale of such bonds. The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds. Because the tax in question is described as an 'income tax' and the profits on sales are included in 'income,' the distinction is not lost between the nature of a tax applied to interest and that of a tax applied to gains from sales. The federal income tax acts cover taxes of different sorts. [Case cited] The tax upon interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of use or disposition of the security. The tax upon profits made upon purchases and sales is an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as 'the creation of caiptal, industry and skill.'"

The decision then goes on to state that a tax upon the profits of such sales did not lay such a burden on the exercise of a State's borrowing power as to make unconstitutional the imposition of an income tax thereon by the Federal Government.

The present case is distinguished from the Willcuts case, in that in the Willcuts case the obligations were those of a State and there was no specific provision of exemption, while in the present case the obligations were issued under a specific statute of the United States which provided for the exemption of income derived therefrom.

Other cases cited by appellee are readily distinguishable. In Igleheart v. Commissioner, 5 cir., 77 F. (2d) 704, 712, Federal Farm Loan Bonds were included in the gross estate of the decedent (Igleheart and others were executors of the estate) subject to the estate tax. The levied and collected tax was not on income; a few lines from the decision will serve to explain the court's position.

"The estate tax is not a tax on property. It is an excise on the privilege of transmitting property of a decedent upon his death; the amount of the tax being measured by the value of the property

transmitted. * * * The provision exempting from taxation Federal Farm Loan bonds and the income therefrom is not violated by measuring the estate tax by the value, at the time of the decedent's death, of all of his property, including such bonds, as the United States may tax the transmission of property upon the death of its former owner, regardless of the character of that property." (Citing Plummer v. Coler, 178 U. S. 115, and Murdock v. Ward, 178 U. S. 139, also cited by the appellee.)

United States Trust Co. of New York v. Commissioner, 2 cir., 98 F. (2d) 734, involved the inclusion in gross estate of proceeds of a War Risk Insurance policy, and there likewise the tax was upon the right to transfer property at death, which is comparable to the Igleheart case immediately above. In Phipps v. Commissioner, 10 cir., 91 F. (2d) 627; Hammersley v. United States, Ct. Cl., 16 F. Supp. 768; and Central Hanover Bank & Trust Co. v. United States, Ct. Cl., 14 F. Supp. 541, the exemption from taxation extended only to principal and interest, not to "income."

While not of importance to the case at hand, it is interesting to note that the Supreme Court of the United States held invalid a recording tax upon mortgages in the state of Alabama, so far as the tax affected mortgages of the Federal Land Banks in that state (Federal Land Bank v. Crosland, 261 U. S. 374) and the District Court of Appeal in California held the State sales tax inapplicable to supplies purchased in that state by the Federal Land Bank (M. G. West Co. v. Johnson, 66 P. (2d) 1211).

Judgment reversed, and cause remanded.

[Endorsed:] Opinion. Filed Aug. 30, 1939. Paul P. O'Brien, Clerk.

Judgment

United States Circuit Court of Appeals for the Ninth Circuit

No. 9100

ASHBY OLIVER STEWART, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Upon appeal from the District Court of the United States for the Northern District of California, Southern Division.

This cause came on to be heard on the Transcript of the Record from the District Court of the United States for the Northern District of California, Southern Division and was duly submitted:

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is reversed, and that this cause be, and hereby is remanded to the said District Court.

[Endorsed:] Judgment. Filed and entered August 30, 1939. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit

No. 9100

ASHBY OLIVER STEWART, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Certificate of clerk, U. S. Circuit Court of Appeals for the Ninth Circuit, to record certified under Rule 38 of the revised rules of the Supreme Court of the United States

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing one hundred and forty (140) pages, numbered from and including 1 to and including 140, to be a full, true and correct copy of the entire record excluding original exhibits of the above-entitled cause in the said Circuit Court of Appeals, made pursuant to request of the Honorable Robert H. Jackson, Solicitor General of the United States, counsel for the appellee, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this sixteenth day of January 1940.

[SEAL] PAUL P. O'BRIEN, *Clerk.*

In the Supreme Court of the United States

October Term, 1939

UNITED STATES OF AMERICA

v.

ASHBY OLIVER STEWART

Order extending time within which to apply for a writ of certiorari

On consideration of the motion of counsel for the petitioner in the above-entitled cause, and good cause therefor having been shown, it is now here ordered that the time within which a petition for a writ of certiorari may be filed herein be, and the same hereby is extended for a period of sixty (60) days from November 30, 1939.

Dated this 24th day of November 1939.

STANLEY REED,
Associate Justice of the Supreme Court of the United States.

U. S. GOVERNMENT PRINTING OFFICE: 1940

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Supreme Court of the United States

Order allowing certiorari

Filed March 25, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE: 1940